SUPREME COURT, U.S.

No. 697 .

FILED
DEC 31 1957
JOHN T. FEY, Clerk

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7391

SOUTH CAROLINA GENERATING COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

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1 . 7393

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
Petitioner,

v.

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents,

Appendix to Brief of Respondent

Federal Power Commission

Part II

TABLE OF CONTENTS

FPC Exhibit No.		
12 (R. 1300-1357)		Power Contract Between South Carolina Generating Company, South Carolina Electric and Gas Company First National Bank of South Carolina of Columbia, South Carolina, and I. E. du Pont De Nemours and Company
18		Federal Power Commission Staff Rate of Return Study
	p. 10h R. 1482	
	p. 11 R. 1483	
	p. 12 R. 1484	
	p. 14 R. 1486	
	p. 15 R. 1487	
28 (R. 1543)		South Carolina Generating Company, Estimate of Revenue Deductions, Georgia Power Company Contract
35 (R. 1556-1561)		Contract between South Carolina Electric and Gas Company and South Carolina Generating Company -- Construction of Transmission Facilities and Agreement to Back Up
Exhibit A to Item A (R. 1720-1750)		Power Contract between South Carolina Generating Company and South Carolina Electric and Gas Company

Exhibit 12
R. 1300

POWER CONTRACT

BETWEEN

SOUTH CAROLINA GENERATING COMPANY

SOUTH CAROLINA ELECTRIC & GAS COMPANY

FIRST NATIONAL BANK OF SOUTH CAROLINA OF

COLUMBIA, SOUTH CAROLINA

AND

E. I. DU PONT DE NEMOURS AND COMPANY

M. 1201

This Agreement, dated the 9th day of March, 1954, effective as of the 11th day of January, 1952, by and between E. I. duPont de Nemours and Company, a corporation organized and existing under the laws of the State of Delaware, hereinafter sometimes called "duPont", and South Carolina Generating Company, a corporation organized and existing under the laws of the State of South Carolina, hereinafter sometimes called "Generating Company", the South Carolina Electric & Gas Company, a corporation organized and existing under the laws of the State of South Carolina, hereinafter sometimes called "Electric & Gas", and the First National Bank of South Carolina of Columbia, South Carolina, sometimes hereinafter called the "Bank", as depository trustee,

WITNESSETH THAT:

WHEREAS, duPont has heretofore entered into a contract (No. AT(07-2)-1, effective as of August 1, 1950, which contract, all supplements, amendments and appendices thereto and any substitute therefor, and all supplements, amendments and appendices to any substitute are collectively hereinafter called the "principal contract") with the United States of America, hereinafter known as the "Government" acting through the U. S. Atomic Energy Commission, hereinafter known as "AEC", authorizing duPont, among other things, to design, construct and operate for AEC certain facilities at or near Aiken, South Carolina, hereinafter known as "the Savannah River Plant"; and

WHEREAS, Generating Company proposes to construct a

steam electric generating station to be known as Urquhart Station on the South Carolina side of the Savannah River at or near Beech Island, southeast of Augusta, Georgia, which will have a capacity of 150,000 KW, consisting of a first 75,000 KW unit which is planned to be in operation by December 14, 1953, and a second 75,000 KW unit which is planned to be in operation by February 10, 1954, subject to delays beyond the control of Generating Company; and

WHEREAS, duPont is desirous of purchasing for use at the Savannah River Plant, electric capacity and energy from the Urquhart Station of Generating Company, under the terms and conditions hereinafter set forth; and

WHEREAS, Electric & Gas and Generating Company have been performing pursuant to a letter of intent from duPont dated January 11, 1952, accepted by Electric & Gas and Generating Company on January 23, 1952, and approved by AEC on February 7, 1952; and

WHEREAS, it is contemplated that this agreement will be pledged as collateral security by the Generating Company to Mellon National Bank and Trust Company, as Trustee, under an Indenture further securing First Mortgage Bonds of the Generating Company,

NOW, THEREFORE, in consideration of the covenants and agreements hereinafter contained, the electric service to be furnished and the sums of money to be paid, said parties hereto for themselves, their successors and assigns, hereby agree with

each other, each party agreeing only to do those acts, or to be bound only by those things, which that particular party specifically agrees to do, or by which that particular party specifically agrees to be bound, as follows:

ARTICLE I
FACILITIES TO BE PROVIDED

Section 1.01 Generating Station: Generating Company will proceed expeditiously with the design, purchase and construction, and operation and maintenance of its Urquhart steam electric generating station, to consist of two 75,000 KW turbo-generators, as more fully described in Exhibit "A", together with necessary auxiliary equipment, step-up substation and switching facilities, at the location described above, said station and additional facilities being sometimes hereinafter referred to as the "Urquhart Station", and it is specifically understood that when hereinafter used the words "Urquhart Station" shall have that meaning only; and Generating Company hereby agrees to exert its best efforts to have both units in commercial operation on the dates aforesaid.

Section 1.02 Transmission Facilities: Electric & Gas will proceed expeditiously with the design, construction, operation and maintenance of a single 115 KV transmission line to deliver the electric energy herein contracted for to be delivered by the Generating Company to duPont, said line to be constructed from the 115 KV switchyard of the Generating Company to a mutually acceptable terminal delivery point on the project site, at which

point duPont will furnish, without cost to Generating Company or Electric & Gas, the necessary terminal facilities.

Section 1.03 Changes in System of Electric & Gas: Electric & Gas will proceed to make such changes and improvements in its system as were outlined in its schematic diagram #SS-2217 (dated September 18, 1951), excluding the switchyard of the Generating Company located at the Urquhart Station, which diagram was attached to its letter dated September 18, 1951. Such changes are now fully shown and delineated in Exhibit "B" hereto.

Generating Company and Electric & Gas will also establish or cause to be established interconnections between the Station and the system of Electric & Gas, by means of which there will be afforded additional security of service to the Savannah River Plant from the system of Electric & Gas.

Section 1.04 Ownership of Facilities: All facilities provided by Generating Company in accordance with Section 1.01 shall be the responsibility of Generating Company and shall be and remain the property of Generating Company; all facilities described in Section 1.02 and Section 1.03 shall be and remain the property of Electric & Gas and all facilities beyond the point of delivery shall be the responsibility of duPont and shall be and remain the property of AEC.

Section 1.05 Easement on Project Property: DuPont will secure from AEC, free of cost to Electric & Gas a grant of easements or rights-of-way, together with rights of ingress, egress,

and access, subject to provisions of Section 6.12 hereof, as may be necessary for Electric & Gas to fulfill its responsibilities hereunder for the installations, testing, maintenance, and operation of facilities in or upon the Savannah River Plant. This easement shall be limited in duration to the life of the contract plus one year.

Section 1.06 Construction and Operation in Prudent Manner: Generating Company shall construct and operate the Urquhart Station, and Electric & Gas shall construct and operate the new transmission facilities herein referred to in a careful, prudent, and efficient manner, to the end that the quality and continuity of service furnished to the Savannah River Plant shall be excellent and that all operating and transmission costs which affect the rate to the Savannah River Plant shall be at a minimum consistent therewith.

Section 1.07 Construction of Additional Capacity: Generating Company may, if it so desires, increase the generating capacity at the site of the Urquhart Station by adding a unit or units in addition to those described in Section 1.01 and Exhibit "A" but any such additions shall not affect this agreement except to the extent herein specifically provided.

Section 1.08 Portion of Capacity of Urquhart Station Allocated to Savannah River Plant: Of the 150,000 KW capacity of the Urquhart Station, 30,000 KW is allocated to the Savannah River Plant, subject to the provisions hereinafter set forth.

Section 1.09 Maintenance of Turbo-Generators, Boilers

and Accessory Equipment: Generating Company agrees to maintain its turbo-generators, boilers, condensers and accessory equipment essential to the operation of Urquhart Station throughout the term of this agreement in such manner as to insure operation of all such equipment at full load, except during periods of outages for inspection and maintenance, or as a result of failure of such equipment. It is the intention of the parties that such equipment shall be taken out of service for maintenance and inspection at times when it is least likely to be needed in service. In event of failure of any such equipment, Generating Company agrees to replace or repair such equipment so as to restore it to service as quickly as possible, and Electric & Gas agrees to supply the deficiency in such electric service unless such deficiency results from one or more of the causes set forth in Article VI, Section 6.04, hereunder.

Section 1.10 Delivery Equipment: All necessary apparatus at Urquhart Station, such as high voltage switches, metering, communication, telemetering, and protective equipment required to deliver electric capacity and energy as herein provided shall be installed by Generating Company.

Section 1.11 Insurance: Generating Company shall carry insurance to protect the Station from loss or damage, and to protect Generating Company against claim or damage to employees, other persons or property, the insurance to be carried to be that regarded as proper and reasonable by electric utility operating companies. Generating Company agrees to furnish annually its

insurance program to duPont. The cost of such insurance shall be included in expenses used in determining the capacity charge.

ARTICLE II
USE OF FACILITIES AND DELIVERIES OF POWER

Section 2.01 Delivery Point: Electric energy shall be delivered to duPont at a terminal point on the Project site as has been mutually determined by duPont and Electric & Gas; such point is hereby designated and hereinafter referred to as the "delivery point". Provided, however, that the measurement of energy for purposes of payment and computation shall be as indicated hereunder in Section 2.02, and duPont shall pay for all line losses between the point of metering and the delivery point.

It is understood and agreed that the transmission line from the Urquhart Station to the "delivery point" shall be used solely to transmit electric capacity and energy between the Urquhart Station and the delivery point, and that no power user other than the Savannah River Project will be connected thereto.

Section 2.02 Metering: Metering of the electric demand and of the electric energy to be delivered to duPont herein referred to shall be at the Urquhart Station sub-station at approximately 115 KV.

Section 2.03 KW Contract Demand: The term "KW Contract Demand" shall mean 30,000 KW. Upon notice to duPont on or after January 1, 1954, that the second unit of the Station is ready for commercial operation, Generating Company agrees at all times to make available, as herein provided, to duPont and duPont agrees, as herein provided, to take, at the metering point, its

KW Contract Demand, or any portion thereof scheduled by duPont.

Section 2.04 KVA Demand: While taking 30,000 KW duPont shall be entitled to take up to 34,500 KVA. In event duPont desires to schedule KW deliveries below its KW Contract Demand, and if such reduction in demand is not taken and paid for by Generating Company under subsection (g) of Section 3.02, of Article III hereof, duPont may take the full amount of reactive KVA made available by such reduction in its KW receipts.

Section 2.05 Character of Energy: The electric energy to be furnished hereunder shall be of the character commonly known as three-phase alternating current at approximately 60 cycles per second and at an average voltage of 117 KV at Urquhart Station bus. It is the intent of Generating Company to operate this bus voltage within the limits of 115 to 120 KV. Every reasonable effort will be made by both Generating Company and duPont, when duPont elects to operate in parallel, to operate their respective systems within these limits.

Section 2.06 Other Equipment: If duPont desires special 115 KV voltage regulating, communication or control apparatus at the Station for use in connection with the receipt of electric energy hereunder, Generating Company agrees to provide space for the installation of such apparatus. Representatives of duPont shall at all times have access to tne premises of Generating Company's Urquhart Station for the purpose of inspection and maintenance of such apparatus. DuPont may at any time at its option and expense remove any of the facilities installed

under this Section 2.06 from Generating Company's property.

ARTICLE III
RATES AND CHARGES

Section 3.01 Basis: Payment shall be made monthly on the basis of a capacity charge plus an energy charge.

Section 3.02 Capacity Charge: The capacity charge shall be at the base rate of nineteen dollars ($19.00) per year per kilowatt of Contract Capacity hereunder, starting on January 1, 1954, or as soon thereafter as duPont is notified that the second unit is ready for commercial operation, whichever is later, subject to adjustment as follows:

(a) For any fraction of a year, the capacity charge shall be determined thus: For each calendar month, one-twelfth of the annual capacity charge: and for each part of a calendar month, that proportion of one-twelfth of the annual capacity charge which the part of the calendar month under consideration bears to the whole of said month.

(b) Generating Company shall, if it shall hereinafter install at the site of the Urquhart Station any turbo-generator in addition to those described in Section 1.01 and Exhibit "A", reduce the plant cost of the Station by $581,000.00, representing the mutually agreed upon amount of investment in the Station which is expended solely to provide for additional turbo-generators, and the capacity charge provided for in Section 3.02(c) shall be adjusted in accordance with the formula set forth below, effective as of the date the Capacity Charge first becomes due.

(c) The base rate of the capacity charge has been calculated to include certain fixed charges for financing, such as interest, amortization and eight per cent (8%) return on equity capital, the total of which will amount to $1,576,240 per year based on an estimated total expenditure as follows:

For Plant Cost	$23,400,000
For Working Capital including coal stocks	1,000,000
	$24,400,000

Plant cost of the Station shall consist of the cost of the direct production facilities, the step-up substation and switching facilities at the Station and any related general plant investment, all as defined by the Federal Power Commission Uniform System of Accounts prescribed for public utilities and licensees as in effect at the date hereof (hereinafter called the "Uniform System of Accounts").

Working capital shall consist of the investment in materials and supplies applicable to the ownership and operation of the Station and properly includable in Account 131.1 of the Uniform System of Accounts, including coal stocks not in excess of 100,000 tons, plus an amount equal to one-sixth of the total annual operating expenses, excluding taxes, depreciation and amortization, of Generating Company which are applicable to the ownership and operation of the Station as shown on the books of Generating Company.

The estimated annual fixed charges of $1,576,240 amount to approximately $10.50 per kilowatt based upon 150,000 KW

capacity. In the event the total expenditure for items shown in this Section 3.02(c) exceeds the estimated total of $24,400,000, the capacity charge shall be increased at the rate of one (1) cent per KW-year for each one-tenth of one per cent (1/10%) increase in such total expenditure. In event such total expenditure is less than $24,400,000, the capacity charge shall be decreased at the rate of one (1) cent per KW-year for each one-tenth of one per cent (1/10%) decrease in such total expenditure.

The adjustment in capacity charge provided in the preceding paragraph, in so far as it is affected by plant cost, shall be determined as soon as such final expenditure figures are available, but not more than twelve (12) months after the second unit is placed in commercial operation, and shall be retroactive to the date electric capacity and energy are first delivered to duPont hereunder.

The adjustment in capacity charge provided for in the second preceding paragraph, insofar as it is affected by working capital, shall be determined at the beginning of each calendar year, applicable for the ensuing calendar year, as the average of the month-end balances during the preceding calendar year of the investment in materials and supplies as defined above, plus an amount equal to one-sixth of the operating expenses for the preceding calendar year as defined above; provided however, that for the period between the beginning of commercial operation and the end of the first full calendar year thereafter, working capital shall be considered as $1,000,000, subject to retroactive

adjustment for any difference between such estimate and the working capital as computed in accordance with the above procedure.

In case additional expenditures applicable to the plant cost of the Station are made during the term of this agreement by Generating Company to improve efficiency, to utilize other fuels, to replace equipment, including replacements occasioned by casualties not reimbursed by insurance or otherwise, or for other purposes to be mutually agreed upon, such expenditures shall be added to those set forth above, in this Section 3.02(c), provided that such expenditures are chargeable to Plant Account under the Uniform System of Accounts, and the capacity charge shall be adjusted at the end of each month in accordance with the formula set forth above, to apply from the beginning of the ensuing month.

(d) The total capacity charge also includes expenses related to the ownership of the Urquhart Station, the maintaining of an operating organization, and the performance of all corporate, legal, administrative and general functions which may be appropriate in the premises, in a total estimated annual amount of $720,000 for such expenses, including taxes other than those covered in Section 3.03. These annual expenses have been estimated as follows:

1.	Federal, State and Local Taxes	$460,000
2.	Administrative and General Expense	60,000
3.	Operating Supervision and Labor	200,000
		$720,000

The above expenses are limited to those applicable to

the ownership and operation of the Station and chargeable under the Uniform System of Accounts to Account 507, and the accounts for Production expenses, Transmission Expenses, and Administrative and General Expenses, exclusive of those amounts covered in Section 3.03.

These estimated annual expenses of $720,000 amount to approximately $4.80 per KW based upon 150,000 KW capacity. In event these annual expenses, actual or computed as herein provided, exceed the estimated total of $720,000 for any calendar year, the capacity charge shall be increased at the rate of one cent per KW year for each two-tenths of one per cent (2/10%) increase in such total expenses. In event these expenses for any calendar year fall below $720,000, the capacity charge shall be decreased at the rate of one cent per KW year for each two-tenths of one per cent (2/10%) decrease in such total expenses.

Taxes shall be included in the determination of the annual expenses in this sub-section 3.02(d) for the purpose of establishing the adjustment in the preceding paragraph, to the extent and in the manner prescribed in Section 3.04.

The adjustment in capacity charge provided for above in this Section 3.02(d) shall be made as soon as possible after the close of each calendar year, and shall be retroactive to the beginning of said calendar year; and such adjusted annual rate of capacity charge shall become the basis of billing during the ensuing calendar year, subject to adjustment as above at the end of such calendar year. Nothing herein shall prevent the parties

hereto from agreeing upon a further adjustmemt in rate for any or all of the intervening months, subject to the year-end adjustment herein provided.

(e) It is recognized by the parties hereto that the foregoing capacity charge of $19.00 per KW per annum is composed of two principal parts, namely, a constant part of $3.70, and a fluctuating part of $15.30. ~~This~~ part of $15.30 it is recognized, is based on certain estimated costs as stated in the foregoing paragraphs of this Section 3.02, and is subject to variations as these costs fluctuate, all as stated in this Agreement. The $3.70 part, however, remains constant and is added to the fluctu - ating part.

(f) Generating Company shall advise duPont in writing the date on which the second unit shall be ready for commercial operation.

(g) If for any calendar month any portion of the contractual capacity of 30,000 KW is not used by duPont, and such capacity is used for that month by Generating Company, Generating Company will credit duPont with 40 cents per KW-month for each KW not used during that calendar month by duPont but used by Generating Company.

(h) In addition to the $19.00 KW-year capacity charge as shown in paragraph (e) of this Section 3.02, there will be an additional annual capacity charge equal to fifteen per cent (15%) of the total cost of the transmission line between the Station and the point of delivery to the Project. "Total cost of the

transmission line" shall include all costs relating thereto, including but not limited to cost of acquiring and clearing rights-of-way, materials, labor, etc.

Payment of this additional annual capacity charge shall begin immediately upon completion of this line or the readiness of the first unit for commercial operation, whichever date is the later, but not before January 1, 1954.

Section 3.03 Energy Charge: (a) The energy charge, for energy furnished each month under the provisions of this agreement, shall be (1) a proportionate part of Generating Company's expenses for fuel and maintenance not reimbursed by insurance which are applicable to the Station and are properly chargeable to Accounts 703, 706, 707, 708, 709, 747, 748, 749, 750 and 751 of the Uniform System of Accounts in the proportion for each month as the kilowatt-hours taken by duPont, plus associated step-up transformer losses to be determined from manufacturer's test data and other related factors, bear to the total net kilowatt-hours generated by the Station, plus (2) any taxes associated with or attributable to transactions or charges under this Section 3.03(a), to the extent and in the manner prescribed in Section 3.04.

To avoid possible inequities in the foregoing proportionate determination of maintenance expense entering into the energy charge month by month, an adjustment of such energy charge shall be made at the end of each calendar year so that duPont shall, for such annual period, pay that proportion of the total

maintenance expense for such period as the kilowatt hours taken during such annual period by duPont, plus associated step-up transformer losses, bear to the total net kilowatt-hours generated during such annual period by the Station. Net kilowatt-hours generated is defined as total gross generation of the Station, less energy required in the operation of the Station.

If Generating Company increases the generating capacity at the site of the Urquhart Station as provided in Section 1.07, the fuel costs used in determining the energy charge shall be based on the average cost of all fuels used by all units in the plant.

(b) Whenever the Generating Company is unable to produce, at its generating Station, the entire contract demand required by duPont under this agreement, and supplemental power is obtained by the Generating Company from Electric & Gas for such purpose, the energy charge per kilowatt hour for such supplemental power shall be the weighted average fuel cost plus fifteen per cent (15%) for all of Electric & Gas's fuel plants for the month during which such supplemental power is supplied.

(c) If and when Generating Company shall install at the site of the Urquhart Station any turbo-generator in addition to those described in Section 1.01 and Exhibit "A", operating expenses will be allocated on the basis set forth in Exhibit "C" hereto, on and after the date upon which the said third unit goes into commercial operation.

Section 3.04 Taxes:

(A) Energy Charge: The tax component to be included

with other expenses for allocation (in the ratio of kilowatt-hours) in the energy charge, under Section 3.03(a) shall:

(1) Include only such taxes as are affected by the volume of output of electric energy from the Station or activities or transactions related thereto, such as all taxes, licenses and levies which are or may be levied, or imposed upon or payable by Generating Company by reason or on account of the production, generation, transmission, sale or delivery of electric energy, including taxes on the purchase, use, delivery or other transactions or events relating to fuel used in the production of electric energy (to be accounted for and charged for as a component of fuel cost) and relating to materials, supplies and equipment used in maintaining the Station (to be accounted for and charged for as a component of maintenance cost) and all taxes on or measured by gross receipts or gross revenues realized from the energy charge under Section 3.03(a), excluding, however,

(a) All taxes, licenses and levies measured by or imposed on net income, net operating income, or excess profits; and

(b) All payroll and employment taxes, and

(2) Be in an amount equal to all taxes covered by Section 3.04(A)(1), including any pyramiding of such taxes which shall result from the inclusion of the tax component in the receipts or revenues to be derived from the energy charge under Section 3.03(a).

(B) Capacity Charge: The tax component to be included, in lieu of the estimated annual taxes of $460,000, in determining the total annual expenses for allocation (in substantially the ratio of contract demand to Station capacity) in the capacity charge, by means of adjustments prescribed in Section 3.02(d), shall:

(1) Include all taxes, licenses and levies which are or may be levied, or imposed upon or payable by Generating Company except to the extent that the amount of any tax has been included in the tax component ir Section 3.04(A) or is chargeable to Plant Account under the Uniform System of Accounts, and

(2) Be in an amount equal to all taxes covered by Section 3,04 (B)(1), including any pyramiding of such taxes which shall result from the inclusion of the tax component in the receipts or revenues to be derived from the capacity charge under Section 3.02(d).

(C) Taxes on Income: In determining the amount of any tax on or measured by net income, net operating income or excess profits, to be included in the tax component pursuant to the provisions of Section 3.04(B), the following adjustments shall be made:

(1) The gross base or measure of such tax shall be limited to the gross revenues of Generating Company from the energy charge and the portion of the capacity charge referred to in Sections 3.02(c) and 3.02(d) payable by duPont and

amounts in respect of the same items payable by any other purchaser of power from Generating Company. In the event the charges of Generating Company to any purchaser of power on account of the energy charge and the items included in the portion of the capacity charge referred to in Sections 3.02(c) and 3.02(d) hereof, should be at rates greater or less than the charges on account thereof made to duPont for the same period, there shall nevertheless be included in the gross base or measure of the taxes referred to in this Section 3.04(C)(1) an amount on account of such sales based on the rates charged duPont for said period, determined in the case of the energy charge on a per KWH basis and in the case of the capacity charge on the basis of the charge per KW year of KW Contract Demand.

(2) In the case of any such tax in respect of which depreciation and interest shall be allowed as deductions, the amortization and interest included in any taxable period in the financing charges under Section 3.02(c) computed as 87.6161% of the capacity charge made under Section 3.02(c) shall be substituted and used in lieu of the depreciation and interest allowed as deductions to Generating Company for such taxable period in determining such tax, provided however, that in the case of any tax in respect of which either depreciation or interest (but not both said items) shall be disallowed as a deduction, such amortization or interest included in said financing charges shall

be substituted and used in lieu of depreciation allowed or the interest allowed, as the case may be, in determining such tax.

(3) There shall not be taken into account deductions and losses attributable to debt retirement, refinancing, casualties and abandonments, and other expenses or deductions not attributable to or used in determining the charges to duPont under Sections 3.02(d) and 3.03(a), and the carry-over and carry-back of losses, deductions, unused credits, and other adjustments.

(4) The amount of such tax liabilities shall be determined on a separate return basis.

(D) Exemptions, Apportionment and Preferential or Discriminatory Taxation: In the event that a portion of the gross revenues, property, purchase price, or other base or measure of any tax shall be exempt from any tax due to the nature of the use or ownership of property, or the exempt character of the transaction, or the exempt nature of the purchaser or user, or purchase or use, of electric energy or similar exemptions (or shall be reduced by allocation or apportionment), such tax shall, in determining the amount thereof to be included in the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B). be computed as if the entire measure of Generating Company's base for such tax for the taxable period is exempt (or is reduced by allocation or apportionment) in the proportion that the measure thereof applicable to transactions or dealings with or receipt

from or otherwise attributable to duPont shall be exempt (or shall be reduced by allocation or apportionment), provided, that in the case of graduated rates, the average rate shall be applied to the said base or measure, as provided in Section 3.04(E).

In accordance with this Section 3.04(D), it is recognized by the parties that to the extent energy sold under this agreement for the operation of the Savannah River Plant is exempt from the South Carolina tax on the generation and sale of power (Article 1, Title 65, 1952 Code of Laws of South Carolina, as amended, and Resolutions of the State Budget and Control Board dated June 11, 1951 and March 1952), such tax shall not be included in the tax component provided by Section 3.04(A).

This Section 3.04(D) shall apply to preferential, discriminatory or special taxation applied to particular persons, property or transactions, but shall not apply to general exemptions such as the elimination from the base of a tax of a minimum amount of revenues or income.

(E) Graduated Rates: In determining the amount of any tax, other than taxes on or measured by net income, net operating income or excess profits, to be included in the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B), each such tax shall be deemed to be imposed at a level average rate, which shall be the effective rate of such tax as applied to the entire measure of Generating Company's base for such tax for the taxable period.

(F) Applicable Tax Period: In determining the amount

of any tax to be included in the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B), such taxes shall be determined by reference to the base or measuring period, it being the intention of the parties that in the event a tax is imposed on a privilege, franchise, or other subject for a period which differs from the period by which the base or measure thereof is determined, the tax shall be deemed, for purposes of this agreement, to be applicable with respect to the base or measuring period.

(G) Deductible Taxes: If, in computing the amount of any tax, another tax is deductible or may be offset or credited, the amount thereof to be considered deductible, offset or credited, in determining the tax component to be included pursuant to the provisions of Sections 3.04(A) and 3.04(B), shall be subject to the provisions of Sections 3.04(C), 3.04(D), 3.04(E) and 3.04 (F).

(H) Adjustment for Prior Years: The determination of the amount of any tax included in the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B) for any prior year shall be subject to adjustment in respect of any tax applicable to such year at the time such tax is subsequently required to be paid to a taxing authority by Generating Company and also upon the final determination of the amount of such tax liability made by Generating Company with the taxing authority, whether by settlement, litigation or otherwise. The amount of the tax component for such prior period shall be recomputed as provided by this

Section 3.04 so as to consider, where applicable, the amount of such taxes so to be paid, or as thus finally determined, together with any interest and penalties thereon. DuPont shall promptly pay to Generating Company the amount of the additional energy and capacity charges payable for said period as thus recomputed and Generating Company shall promptly pay to duPont the excess of the amounts theretofore paid by duPont for such period over the energy and capacity charges, as thus recomputed. Generating Company shall have the sole and exclusive authority in its own absolute discretion to settle or otherwise dispose of any or all of its tax liabilities.

(I) Additional Generating Units: In the event that Generating Company should own or operate any power generating facilities other than the Station, or own property or conduct a business not related to the business of generating and selling electricity, the taxes, licenses and levies of Generating Company which shall be taken into account in determining the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B) shall be only such taxes, licenses and levies as are attributable to the ownership and operation of the Station. The taxes, licenses and levies of Generating Company attributable to such ownership and operation of the Station shall be the sum of:

(1) All taxes, licenses and levies of Generating Company which are specifically applicable or are allocable to the Station, including but not limited to ad valorem taxes, payroll and employment taxes with respect to employees

working exclusively at the Station and levies on gross receipts and gross revenues derived from sales of power at said Station; plus

(2) Taxes on or measured by net income, net operating income, or excess profits, as determined under Section 3.04 (B);

(3) A fair and equitable portion of all other taxes, licenses and levies to which Generating Company is or may be subject, by reason of engaging in the business of generating and selling electricity or owning property employed therein.

Section 3.05 Review of Practices and Procedures: While it is recognized that the operation of the facilities referred to in Sections 1.01, 1.02 and 1.03 of this agreement are the responsibility of Electric & Gas and Generating Company, the costs thereof have a direct relation to the cost of power furnished Savannah River Plant under this agreement, and, accordingly, duPont may from time to time review with the Companies their operating plans, practices and procedures, and make recommendations with respect thereto which in duPont's judgement may provide for economy in operation and the companies will adopt such recommendations of duPont as the companies may mutually agree upon with duPont.

Section 3.06 Statements, Audits and Inspection: Generating Company shall furnish to duPont statements in reasonable detail as to all items entering into the determination of capacity charges and energy charges, and such statements shall be

certified by an officer of Generating Company. Generating Company shall furnish to duPont annually a copy of an audit of its books and accounts for the preceding year made by an independent auditor. DuPont and/or AEC shall have access at reasonable intervals to the pertinent books and records of Generating Company and Electric & Gas and the right to audit the same annually, and shall have access to the Urquhart Station for the purpose of inspection.

The Bank, Generating Company and South Carolina Electric & Gas Company agree that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three (3) years after payment under this contract, have access to and the right to examine any directly pertinent books, documents, papers, and records of the Bank, Generating Company and Electric & Gas involving transactions relating to this contract. Nothing in this contract shall be deemed to preclude an audit by the General Accounting Office of any transaction under this contract.

ARTICLE IV
BILLING AND PAYMENT

Section 4.01 Presentation and Payment. Generating Company shall render to duPont on or about the 10th day of each month a written bill for the amount due it by the terms of this Agreement for the preceding calendar month; and as adjustments in charges are determined from time to time hereunder, Generating Company shall promptly render a written bill or credit memorandum for the amount due it or duPont, respectively. All such bills or credit memoranda shall be due and payable by duPont or Generating Company, respectively, within twenty days after

rendition.

All amounts payable to Generating Company by duPont shall be paid directly to the Generating Company, at its main office, unless and until duPont shall receive from the Bank written notice specifying and demanding that payment of all amounts so payable be thereupon and thereafter paid to the Bank. Upon receipt of such notice duPont hereby agrees that all such payments shall thereupon be paid to the Bank until duPont shall have received from the Bank a further notice specifying and demanding that payment of any such amounts shall be made to the person therein specified. Such notices as are contemplated by this paragraph of Section 4.01 may be given from time to time by the Bank, but in no event prior to the time that this contract is pledged as collateral security for the purposes stated in Section 6.07. Any payments made by duPont under direction of the Bank, as herein provided, shall constitute as full satisfaction of the obligation of duPont with reference thereto as if such payments had been made directly to Generating Company.

Section 4.02 Remedies: If duPont shall fail to pay any bill within twenty (20) days after the same is rendered interest at the rate of six per cent (6%) per annum shall run from the time such payment was due, to-wit: the 20th day after the rendition of such bill.

ARTICLE V
METERING

Section 5.01 Metering Equipment: There shall be provided by Generating Company at the Urquhart Station such metering

equipment as may be necessary to measure accurately the electric capacity and energy to be furnished hereunder. Said metering equipment, including generator and station service meters, shall at all times be kept accurate within one per cent (1%) and Generating Company shall read such meters as often as required by duPont but not oftener than once every hour, and shall thereupon transmit such readings to duPont. All measuring instruments shall be of a make and type to be agreed upon by a representative of each of the parties hereto duly appointed for such purpose. All measuring instruments pertaining to billing shall be sealed and shall be opened only in the presence of an authorized representative of each party hereto and all such instruments shall be tested by such representatives upon request of either party to the other, but at least once every six months. If, as a result of such test, any instrument or instruments shall be found to be inaccurate, it shall be restored to a condition of accuracy satisfactory to such representatives or replaced by a new instrument or instruments satisfactory to such representatives. If the inaccuracy of any instrument shall exceed one per cent (1%) then the readings of such instruments previously taken and all charges based thereon, shall be corrected on the basis of said test, but not for more than thirty (30) days prior to the date of test, nor prior to the date within such thirty (30) days upon which such meters have been proven or agreed to be accurate.

DuPont shall have the right to install, at its sole expense, duplicate instruments for checking, and space for the

installation of such instruments shall be provided by Generating Company. Representatives of duPont shall at all times have access to the premises of Generating Company for the purpose of inspection or maintenance of such metering equipment of duPont. Generating Company shall have the right to test for accuracy such duplicate instruments at reasonable intervals.

If either party shall at any time discover that any instrument either original or duplicate, registers inaccurately, or fails to register, then such party shall forthwith so notify the other party in writing. In the event of stoppage of an original instrument in respect to which no duplicate has been installed, or of both the original and duplicate instruments, the amount of electric capacity and energy furnished during the period of such stoppage shall be determined from any instrument readings or other data which may be available and applicable for the purpose, and such determination shall be used for billing hereunder.

Section 5.02 Records: Generating Company shall keep in duplicate a continuous log record of the operation of Urquhart Station on which shall be recorded at the end of every one (1) hour period the readings of all meters and instruments pertaining to the delivery of and billing for electric capacity and energy furnished by it to duPont hereunder. There shall also be recorded in such records a brief statement giving complete detailed facts in so far as possible as to any interruption or other unusual events affecting service. One set of said dupli-

cates shall be mailed each day by Generating Company to duPont at Savannah River Plant.

ARTICLE VI
MISCELLANEOUS

Section 6.01 Responsibility and Indemnification: Neither Generating Company nor Electric & Gas shall be responsible for electric capacity and energy after delivery by it to duPont at the delivery point. Each party hereto expressly agrees to indemnify and save harmless the other against all claims, demands, costs or expense for loss, damage, or injury to persons or property in any manner directly or indirectly connected with or growing out of the generation, transmission or use of electric capacity and energy on its own side of the delivery point hereunder; provided, however, that each party hereto, in so far as any other party hereto is concerned shall in all cases be responsible for damage or injury to its own employees while such employees are on duty, or are on property preparatory to assuming their duties or leaving them, and each party expressly agrees to indemnify and save harmless the other from all claims of such employees, except where the same shall be considered as part of the cost used in determining charges for capacity and energy under Article III.

Section 6.02 Operating Instructions: Generating Company agrees to comply with the reasonable operating instructions of duPont with regard to electric capacity and energy to be supplied under this agreement, and, at all times, to follow the reasonable instructions of duPont in operating the switches and

other apparatus controlling the electric capacity and energy to be supplied hereunder.

Section 6.03 Notice of Failure: In event of the failure of or injury to any apparatus of Generating Company, affecting its ability to supply service in accordance with the terms of this agreement, Generating Compan shall give immediate notice by telegraph or telephone, to the operating headquarters of duPont at Savannah River Plant.

Section 6.04 Force Majeure: In case either party hereto should be delayed in or prevented from performing or carrying out the agreements, covenants and obligations made by and imposed upon said parties, or either of them, by this contract by reason of or through strike, stoppage in labor, failure of contractors, suppliers of material, riot, fire, flood, ice, invasion, civil war, commotion, insurrection, military or usurped power, order of any Court or Judge granted in any bona fide adverse legal proceedings or action, order of any civil authority, or military either de facto or de jure, explosion, act of God, or the public enemies, or any cause reasonably beyond its control, and not attributable to its neglect, then, and in such case or cases, such period of delay or prevention shall not be reckoned or accounted as a part of the time within which such party was to perform and carry out the same, and the days, dates, times and periods (other than the expiration date of this Agreement) mentioned in this contract shall be extended for a period proportionate to such delay or prevention, nor shall such period

relieve duPont of paying the capacity charge as above set forth in Section 3.02; provided, however, that the party or parties suffering such delay or prevention shall use all reasonable diligence to remove the cause or causes thereof, and either party claiming an extension of time hereunder shall immediately give to the other written notice of such claim.

It is, of course, understood and agreed, however, that Generating Company will exert every effort to assure the continuity of supply of the duPont contract demand to duPont and when that amount of power is not available because of the foregoing causes, Generating Company will endeavor upon request of [illegible] power from others at just and reasonable [illegible].

Section 6.05 Regulation: Both parties recognize the fact [illegible] agreement, together with all the terms thereof, may be or may become subject to approval, change, or modification by certain agencies of the Federal Government and of the State of South Carolina charged with the regulation of electric utilities, and no part of this agreement which is, or which shall later become, contrary to any valid rule, regulation, order, or decree of any such agencies shall be binding upon the parties hereto during the period any provision hereof is contrary to any such valid rule, regulation, order, or decree.

Section 6.06 Assignability: This contract shall bind the parties hereto, their successors and assigns, but no assignment hereof shall in any event relieve duPont, Electric & Gas

or Generating Company of any of their obligations hereunder except that an assignment by duPont to the Government shall relieve duPont of its obligations hereunder.

Section 6.07 Hypothecation: The parties hereto agree that this agreement may be pledged as collateral security for the payment of First Mortgage Bonds issued by Generating Company pursuant to its corporate Indenture.

Section 6.08 Agreement under the Contract: Notwithstanding any pledge of this contract as collateral security by Generating Company or the fact that the Bank is a party hereto, duPont and Generating Company are authorized to make any and all agreements contemplated by the several provisions of this contract or required in working out the operation or financial details thereof or construing or interpreting any provisions thereof without the consent of any pledgee or the Bank. No such agreement, however, shall, without the consent of such pledgee and of the Bank, be made with respect to the provisions of Sections 1.01, 6.06 or 7.01, or shall change the basic formulas for the computation of capacity or energy charges, or tax components set forth in Section 3.02 through Section 3.04 inclusive, or affect the rights of the Bank under Section 4.01.

Section 6.09 Restriction on Employment: In the performance of their obligations hereunder, neither Generating Company nor Electric & Gas shall employ any person undergoing sentence of imprisonment at hard labor.

Section 6.10 Interests of Others: No member of or

delegate to Congress, or Resident Commissioner shall be admitted to any share or part of this agreement or to any benefit that may arise therefrom, but this provision shall not be construed to extend to this Agreement if made with a corporation for its general benefit.

Section 6.11 Anti-Discrimination: Generating Company and Electric & Gas, in performing the work required by this Agreement, shall not discriminate against any employee or applicant for employment because of race, creed, color or national origin. See Executive Order No. 9346, dated May 27, 1943.

Section 6.12 Security Clauses:

1. Contractor's Duty to Safeguard Restricted Data, Etc. In the performance of the work under this contract the Generating Company and Electric & Gas shall, in accordance with the Commission's security regulations and requirements, be responsible for safeguarding restricted data and other classified matter and protecting against sabotage, espionage, loss and theft, the classified documents, materials, equipment, processes, etc. as well as such other material of high intrinsic or strategic value as may be in the possession of the Generating Company or Electric & Gas in connection with performance of work under this contract.

2. Regulations: The Generating Company and Electric & Gas agree to conform to all security regulations and requirements of the Commission.

3. Definition of Restricted Data: The term "restricted data", as used in this article, means all data concerning the

manufacture or utilization of atomic weapons, the production of fissionable material, or the use of fissionable material in the production of power; but shall not include any data which the Commission from time to time determines may be published without adversely affecting the common defense and security.

4. Security Clearance of Personnel: Except as the Commission may authorize, in accordance with the Atomic Energy Act of 1946, as amended, the Generating Company and Electric & Gas shall not permit any individual to have access to restricted data until the designated investigating agency shall have made an investigation and report to the Commission on the character, associations, and loyalty of such individual and the Commission shall have determined and advised the Generating Company and Electric & Gas that permitting such person to have access to restricted data will not endanger the common defense or security. As used in this paragraph the term "designated investigating agency" means the United States Civil Service Commission or the Federal Bureau of Investigation, or both, as determined pursuant to the provisions of the Atomic Energy Act of 1946, as amended.

5. Criminal Liability: It is understood that disclosure of information relating to the work or services ordered hereunder to any person not entitled to receive it, or failure to safeguard any restricted data or other information classified "top secret", "secret", or "confidential"defense information that may come to the Generating Company and Electric & Gas or any person under Generating Company's and Electric & Gas's control

in connection with work under this contract, may subject Generating Company and Electric & Gas, their agents, and subcontractors to criminal liability under the laws of the United States, (See the Atomic Energy Act of 1946, 60 Stat. 755, as amended, Title 42, U.S.C., Sec. 1801 et seq. See also Title 18, U.S.C. Sec. 791-797 and Executive Order 10104 of February 1, 1950, 15 F. R. 597).

6. Employment of Aliens: The Generating Company and Electric & Gas will not permit any alien employed or to be employed by it to have access to the Savannah River Plant or to the classified drawings, specifications and accompanying enclosures relating to the performance of the work, or to the classified models or material referred to therein, or to the engineering principles, composition, subassemblies, or assemblies which are classified and vital to the functioning or use of the article or articles forming the subject matter of this order without the written consent beforehand of the Commission.

7. Termination of Contract: Upon termination agreement, the Generating Company and Electric & Gas shall to duPont all documents or materials then in its possessi custody or for which it is responsible, which contain or r restricted data or other classified information or matter the Generating Company and Electric & Gas have received, developed, or prepared in connection with this contract. Until actual delivery thereof to duPont, the Generating Company's Electric & Gas's responsibility for security shall continue

such documents or materials.

8. Subcontracts: Except as otherwise authorized in writing by the Contracting Officer, the Generating Company and Electric & Gas shall insert provisions similar to the foregoing in all subcontracts under this contract.

Section 6.13 Eight-Hour Law: No laborer or mechanic doing any part of the work contemplated by this Agreement in the employ of the Generating Company or Electric & Gas or any subcontractor contracting for any part of said work contemplated, shall be required or permitted to work more than eight hours in any one calendar day upon such work at the site thereof, except upon the condition that compensation is paid to such laborer or mechanic in accordance with the provisions of this Section. The wages of every laborer and mechanic employed by Generating Company or Electric & Gas or any subcontractor engaged in the performance of this Agreement shall be computed on a basic day rate of eight hours per day and work in excess of eight hours per day is permitted only upon the condition that every such laborer and mechanic shall be compensated for all hours worked in excess of eight hours per day at not less than one and one-half times the basic rate of pay. For each violation of the requirements of this Section, a penalty of $5.00 shall be imposed upon Generating Company or Electric & Gas for each laborer or mechanic for every calendar day in which such employee is required or permitted to labor more than eight hours upon said work without receiving compensation computed in accordance with this Section, and all penalties

thus imposed shall be withheld for the use and benefit of the Government: Provided, that this stipulation shall be subject in all respect to the exceptions and provisions of U. S. Code, Title 40 §§ 321, 324, 325, and 326, relating to hours of labor, as modified by the provisions of §303 of Public Act No. 781, 76th Congress, approved September 9, 1940, relating to compensation for overtime.

Section 6.14 Article and Section Headings: The Articles and Section headings in this Agreement have been inserted as a matter of convenience of reference and are not a part of this Agreement.

Section 6.15 Responsibility: The several parties to this contract shall be responsible for the acts herein which they are specifically called upon by the terms of this agreement to perform.

Section 6.16 Covenant Against Contingent Fees: The Bank, the Generating Company and Electric & Gas warrant that no person or selling agency has been employed or retained to solicit or secure this contract upon an agreement or understanding for a commission, percentage, brokerage, or contingent fee, excepting bona fide employees or bona fide established commercial or selling agencies maintained by them for the purpose of securing business. For breach or violation of this warranty, the Government shall have the right to annul this contract without liability or in its discretion to deduct from the contract price or consideration the full amount of such commission, percentage, brokerage, or contingent fee.

Section 6.17 Approval by AEC: This contract shall be subject to the approval of AEC and shall not be binding unless so approved.

R 1338

ARTICLE VII
TERM OF AGREEMENT AND CANCELLATION CHARGES

Section 7.01 Term of Agreement: This contract shall become effective as of its date, as delineated in the beginning of the agreement, and shall continue in full force and effect for a period of twenty-five (25) years from the date the second unit goes into commercial operation, except that the capacity charge for the transmission line shall become due and payable as noted in Section 3.02(h), provided, however, that duPont may cancel this agreement for the convenience of the Government upon the giving of one (1) year's notice in writing to Generating Company and Electric & Gas, upon the payment to Generating Company of the charges hereinafter set forth in Section 7.02.

Section 7.02 Cancellation Charges: The cancellation charges herein stated are in the terms of annual capacity charges as determined by Section 3.02 above. In other words, if cancellation is made during the first year, the charge will be 175% of the annual capacity charge; if cancellation is made during the second year, the charge will be 168% of the annual capacity charge; and so on until if cancellation is made during the fourteenth year, the charge will be 100% of the annual demand charge. For the purpose of this section, the first year is to be considered as covering the period from the date of the contract through the end of the first full calendar year during which power is delivered for such entire year.

1st Year	1.75	2nd Year	1.68	3rd Year	1.57
4th Year	1.51	5th Year	1.47	6th Year	1.43
7th Year	1.35	8th Year	1.28	9th Year	1.20
10th Year	1.16	11th Year	1.12	12th Year	1.09
13th Year	1.06	14th Year	1.00	No charge after the 14th Year.	

7.03 Partial Cancellation: If duPont does not wish to cancel the entire agreement, it may cancel a portion of the KW contract demand, but only to the extent that the KW contract demand is not reduced below 20,000 KW. Notice of such cancellation shall be given by duPont to Generating Company at least one (1) year in advance of the date of the proposed cancellation, and duPont shall pay Generating Company a percentage of the cancellation charges delineated in Section 7.02 equal to the quotient resulting by dividing the number of KW cancelled out by 30,000. In case the entire contract is later cancelled after such a partial cancellation, the cancellation charges due under Section 7.02 shall be computed by multiplying the charges due by the quotient resulting by dividing the then KW contract demand by 30,000.

ARTICLE VIII
ARBITRATION

Section 8.01 Arbitration: Any dispute hereunder between two of the parties hereto arising over a question of fact shall be submitted to three arbitrators, to be selected as follows: One shall be selected by one party, one by the other party, and these two shall select a third, or in case they cannot agree on a third within ten (10) days after the two have been chosen, a third arbitrator shall, upon the written request of

either of the parties hereto, be appointed by any person who is a Judge of the United States District Court of the District in which the Urquhart Station is situated, and the three arbitrators so selected hereunder shall hear and determine the matter in dispute and a decision by a majority of them shall be final and binding upon the parties hereto, provided, however, that if either party shall fail or neglect for a period of ten (10) days after receipt of written notice by the other to select an arbitrator upon its part, the arbitrator appointed by the party giving such notice shall select another arbitrator, and the two thus chosen shall select a third, and the three thus chosen shall proceed to hear and determine the matter in dispute and a decision of the majority of the three shall be final and binding; and provided further, that each of the parties shall be given at least ten (10) days written notice prior to the hearing of any matter submitted to such Board of Arbitrators. The arbitrators' fees and the expense of the arbitration shall be borne and paid for by the party losing in the arbitration, but in the event of a divided award, the division of such fees and expenses shall be made as directed by the arbitrators. The parties to this agreement covenant with each other to abide by the decision of the arbitrators selected hereunder.

The above set forth arbitration shall be conducted pursuant to the arbitration laws of the State of South Carolina as the same now exist in Chapter 22 of Title 10 of the 1952 Code of Laws of South Carolina, or as the same may hereinafter be

amended or re-codified.

IN WITNESS WHEREOF, said Generating Company has caused these presents to be signed in its name by its duly authorized representative, and duPont has likewise caused these presents to be signed in its name by its duly authorized representative, and Electric & Gas has likewise caused these presents to be signed in its name by its duly authorized representative, and the Bank has likewise caused these presents to be signed by its duly authorized representative, all as of the day and year first above written.

ATTEST:
(Sgd.) L. F. Pearce
Secretary

SOUTH CAROLINA GENERATING COMPANY
By (Sgd.) J. M. Costello
Vice President

ATTEST:
(Sgd.) L. F. Pearce
Secretary

SOUTH CAROLINA ELECTRIC & GAS COMPANY
By (Sgd.) S. C. McMeekin
President

ATTEST:
(Sgd.) S. A. Milliner, Jr.
Assistant Secretary

E. I. DU PONT DE NEMOURS AND COMPANY
By (Sgd.) R. M. Evans
Asst. Gen. Mgr. Explosives Dept.

ATTEST:
(Sgd.) W. W. Bruner
Cashier

FIRST NATIONAL BANK OF SOUTH CAROLINA OF COLUMBIA, SOUTH CAROLINA
By (Sgd.) Thomas J. Robertson, Pres.

APPROVED:

(Sgd.) E. M. Block
Atomic Energy Commission

Date April 2, 1954

EXHIBIT "A"
URQUHART STATION

General Features

The steam-electric station constituting the production element of this project will be located on a new site on the east bank of the Savannah River near Augusta, Georgia, approximately 13-1/2 miles west of Aiken, South Carolina.

General facilities to be provided will be those necessary for the development of the new site, comprising: site improvements, including fencing; roadways; railroad trackage for delivery of equipment, material and coal, including that for storage of cars; coal and ash handling facilities; service-water installation; machine shop; warehouses; locomotive, bulldozer, and truck repair shop; administration building.

Arrangement and Structures

The circulating water intake will be at the river bank, with the water pumped therefrom to the station. Condensers will be at an elevation suitable for full siphon action with river levels between minimum pool at 114.5 feet (referred to mean sea level) and maximum flood of record at approximately 141.5 feet.

Turbine-generators will be placed at elevation 145, served by one 150 ton overhead crane. Boiler equipment will be located upstream or north from the turbines, main operating floor being at elevation 145. Top of stack will be at elevation 345.

There will be provided, on the operating floor level between turbine units No. 1 and 2, an enclosed control room, air conditioned

EXHIBIT "A"
URQUHART STATION
(Continued)

and accoustically treated. In this room will be located all operating controls for the two turbine-generator units, the two steam generating units and their accessories, and complete controls for all transmission facilities.

EQUIPMENT

There will be two General Electric turbine-generators, each consisting of a turbine carrying a nominal rating of 60,000 KW and a normal capability rating of 75,000 KW designed to give 75,000 KW gross generation at 2.5 in. Hg abs back pressure, with throttle steam conditions 1450 psig 1000 F and reheat to 1000F, with full five-stage extraction plus provision for 3 per cent (3%) evaporated make-up. Generators, wound for 13.8 kv, will be rated 60,000 kw 0.80 pf, giving 75,000 kva with 0.5-psig hydrogen, and 91,875 kva with 30-psig hydrogen. Each unit will be served by a 250-kw 250-volt direct connected gear driven exciter and amplidyne pilot exciter, separate motor-driven.

River-water temperature varies between a minimum near 40 F and a maximum of approximately 85 F, which will give a usual range of condenser back pressures of from less than 1 in. to approximately 2.5 in. Hg abs. The expected net capability of each plant unit at generator voltage is 75,000 kw; this is after provision for plant auxiliaries, with 1.5 in. Hg abs average back pressure figured as obtainable with Savannah River water, and is with full-extraction from five points.

EXHIBIT "A"
URQUHART STATION
(Continued)

The surface condenser serving each turbine will have 45,000 sq. ft. of surface, being of the two-pass divided water-box type. Circulating water for each condenser will be supplied by two horizontal pumps at intake.

Steam-generating plant will consist of two Combustion Engineering units, each of which is designed to deliver, continuously, 510,000 lb. per hour of steam, when fired with 13,000 btu per lb. coal, carrying 5.0 per cent moisture and 10 per cent ash as received. Each steam generator will be equipped with four No. 533 Raymond pulverizer. Air will be used for soot blowing. All other mechanical auxiliaries will be designed with necessary tolerances for the loads and conditions anticipated.

SUBSTATION

Transformers

Each generating unit will be connected to the 115 kv switchyard through a bank of two three-phase 30/37.5/50 MVA type OA/FA transformers.

One three-phase unit auxiliary transformer will be tapped off each generator main lead circuit to furnish power for the unit boiler and turbine auxiliaries. Auxiliary power distribution will be made at 4160 volts and 480 volts. A second transformer fed from the 46 kv independent incoming line will serve for plant start-up and as a standby for each of the unit auxiliary transformers.

R.1345

EXHIBIT "A"
URQUHART STATION
(Continued)

Switchyard

A 115 kv switchyard will be constructed south of the generating station, with adequate facilities for the transmission of power from this station.

ESTIMATED COSTS

Estimated Direct Cost of Plant as per detailed estimate attached	$20,345,400
Add for metering, general plant investment, engineering fees and interest during construction, escalation and other contingencies -	3,054,600
TOTAL -	$23,400,000

EXHIBIT "A"
URQUHART STATION
(Continued)

CLIENT. SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION. BEECH ISLAND, SOUTH CAROLINA
TITLE. PRELIMINARY ESTIMATE - PROPOSED NEW PLANT

EST. NO. 916-2(JBF)
W.O. No. DB-10-22
REV. 8/17/51

F.P.C. Class	Description	60,000 Kw(75,000 Kw Max.) 1450 Psig-1000°- 1000° Reheat-Install at one time 2-Units Escelation
	POWER PLANT BUILDING	
	Building Substructure	
311-9-2	Excavation, Sheet Piling, Bracing, Dewatering	$ 200,000
311-9-3	Foundations-Forms, Reinforcing, Concrete	635,000
	TOTAL BUILDING SUBSTRUCTURE	$ 835,000
	Superstructure	
311-13-4	Structural Steel	$1,070,000
311-13-5	Walls-Corrugated Transite, Doors, Sash, Glass	315,000
311-13-6	Interior Partitions	45,000
311-13-7	Plastering	8,000
311-13-8	Floors-Concrete	257,000
311-13-9	Roof-Precast Slabs, Waterproofing	106,000
311-13-10	Platforms, Stairways, Handrailing	140,000
311-13-11A	Plumbing, Ventilating)	
311-13-11B	Heating)	
311-13-11D	Fire Protection System)	170,000
311-10-12	House Lighting System	100,000
311-13-13	Painting-Structural Steel only	20,000
311-5-19	Service Elevator	25,000
	TOTAL SUPERSTRUCTURE	$2,256,000
	TOTAL POWER PLANT BUILDING	$3,091,000

R.13

EXHIBIT "A"
UNQUHART STATION
(Continued)

Sheet 2 of 8 Sheets

CLIENT. SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION. BEECH ISLAND, SOUTH CAROLINA
TITLE: PRELIMINARY ESTIMATE - PROPOSED NEW PLANT

EST. NO. 916-2 (JBF)
W.O. NO. DB-10-22
REV. 8/17/51

F. P. C. Class	Description	60,000 Kw (75,000 Kw Max.) 1450 Psig-1000° - 1000° Reheat-Install at one time 2-Units	Escalation
	OTHER STRUCTURES		
311-13-16A	Intake and Discharge Tunnels	$ 500,000	
311-13-16B	Superstructure of Screen House	10,500	
311-13-17B	Yard Lighting	7,000	
311-13-17C	Fence around Property	5,000	
311-13-17E	Roads	25,000	
311-13-17F	Walks and Curbs	6,000	
311-13-17H	Drainage System	20,000	
311-13-17I	Landscaping	6,000	
311-13-22D	Storehouse	40,000	
311-13-24	Railroad Siding	60,000	
300-09	Temporary Buildings	25,000	
311-13-29	Walls	5,000	
311-13-30	Telephone System	3,000	
	TOTAL OTHER STRUCTURES	$ 712,500	
	BOILER PLANT EQUIPMENT		
	Boiler Units		
312A	Boiler Equipment	$3,897,000	$ 303,500
	TOTAL BOILER UNITS	$3,897,000	$ 303,500

EXHIBIT "B"

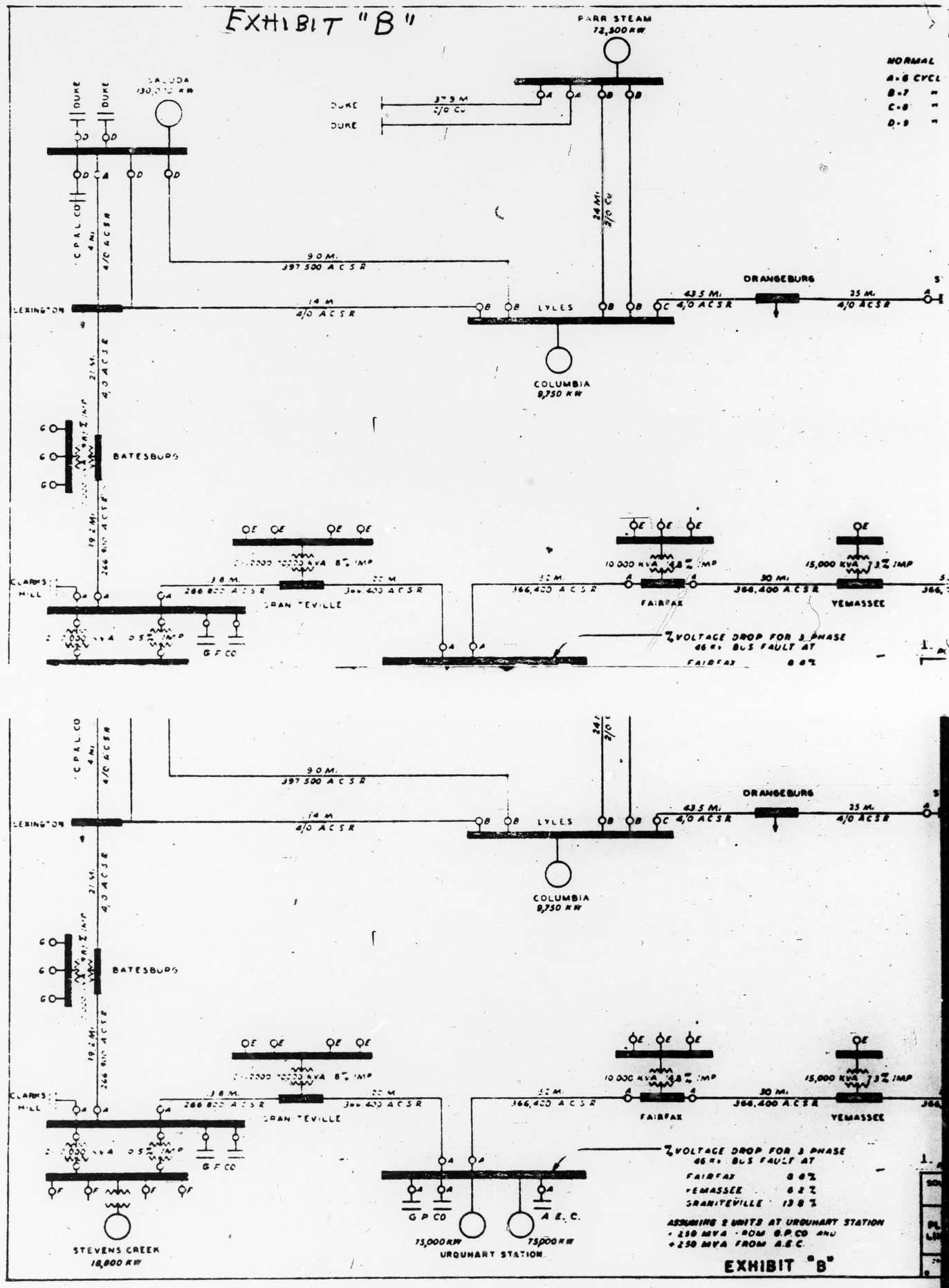

EXHIBIT "B"

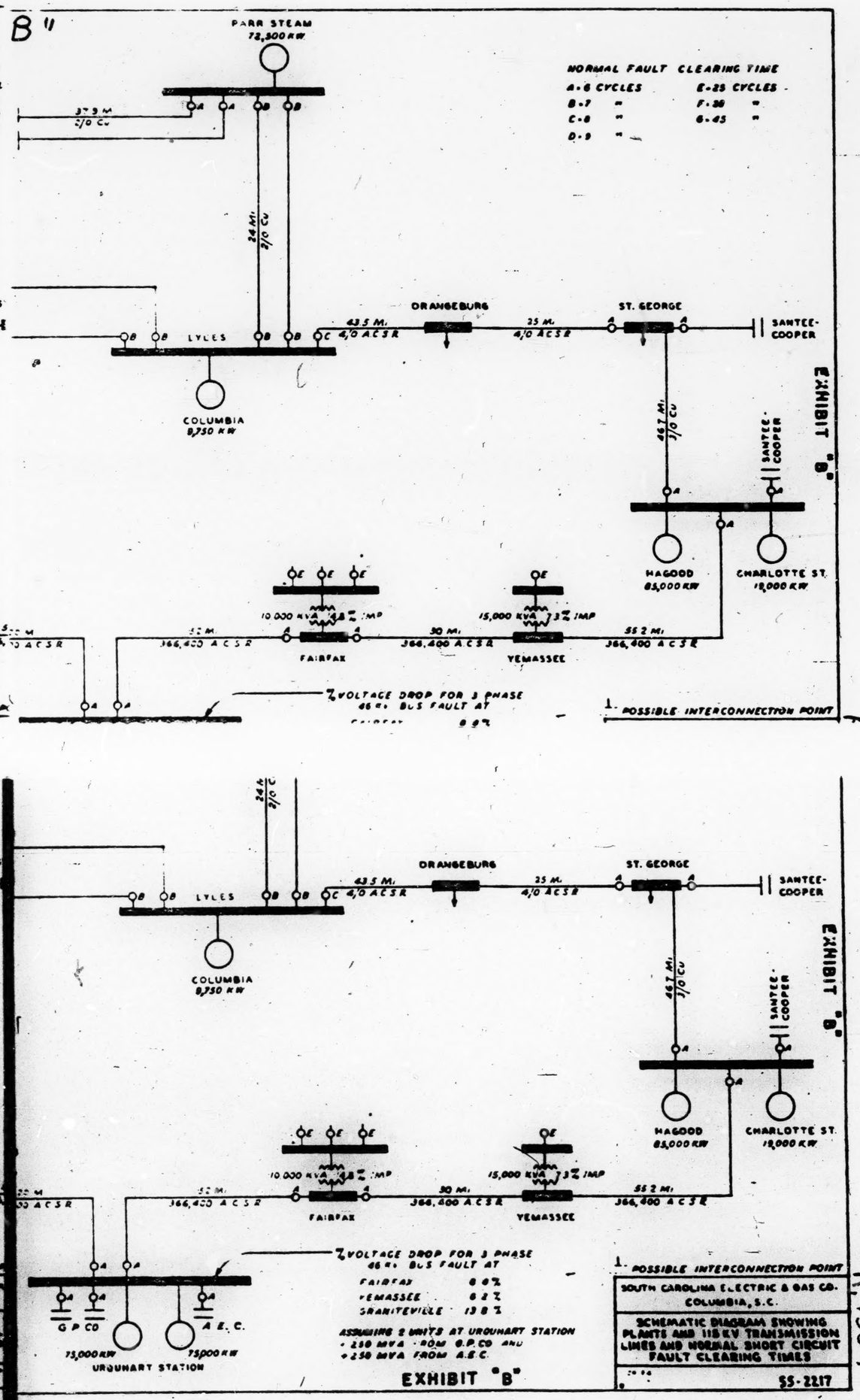

EXHIBIT "B"

R. 1354

EXHIBIT "A"
URQUHART STATION

CLIENT. SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION. BEECH ISLAND, SOUTH CAROLINA
TITLE. PRELIMINARY ESTIMATE - PROPOSED NEW PLANT

EST. NO. 916-2 (JBF)
W.O. No. DB-10-22
Rev. 8/17/51

F.P.C. Class	Description	60,000 Kw (75,000 Kw Nas.) 1450 Psig-1000°-1000° Reheat-Install at one time 2-Units	Escalation
	Draft Equipment		
312B-1	Air Duct System and Insulation	$ 121,200	$ 7,200
312B-2	Air Heater - In Boiler Account		
312B-3	Breeching System, Insulation, Guniting	212,400	11,940
312B-4	Mechanical Dust Collector, Insulation, Guniting	123,200	8,800
312B-5	F.D. and I.D. Fans	205,000	17,000
312B-6&6A	Stack and Stack Foundations	134,000	
	TOTAL DRAFT EQUIPMENT	$ 795,800	$ 44,940
	Feed Water System		
312C-1	Deaerator Heater and Insulation	$ 67,400	
312C-2	Economizer-In Boiler Account		
312C-3-4	Evaporator and Stage Heaters	220,000	
312C-6	Boiler Feed Pumps	340,000	
312C-7	Feed Water Regulators	20,000	
312C-8	Boiler Water Storage Tank	16,000	
312C-9	Miscellaneous Pumps	16,000	
	TOTAL FEED WATER SYSTEM	$ 679,400	
	Raw Coal Handling Equipment		
312D	Raw Coal Handling Equipment including Bunkers, Structures, Conveyors	$ 775,000	$ 35,000
	TOTAL RAW COAL HANDLING EQUIPMENT	$ 775,000	$ 35,000

R.1378

EXHIBIT "A"
URQUHART STATION
(Continued)

CLIENT: SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION: BEECH ISLAND, SOUTH CAROLINA
TITLE: PRELIMINARY ESTIMATE - PROPOSED NEW PLANT

Est. NO. 916-2(JBF)
W.O. NO. DB-10-22
REV. 8/17/51

60,000 Kw (75,000 Kw Max.)
1450 Psig-1000° - 1000°
Reheat-Install at one time

F.P.C. Class	Description	2-Units	Escalation
	TURBINE PLANT EQUIPMENT		
	Turbo-Generator		
314B-1-2-4-7	Turbo-Generator	$3,700,000	$ 344,210
314B-3	Foundations	135,000	
314B-8	Turbine Gland Water Tank	1,400	
314B-9	Turbine Oil Purifier	14,000	
314B-11	Air Duct and Filters	5,000	
314B-10	Water Pump - Air, Oil, Hydrogen Cooler	3,000	
	TOTAL TURBINE PLANT EQUIPMENT	$3,858,400	$ 344,210
	Condensing and Cooling Water System		
314C-1	Air Ejector)		
314C-2	Condenser)		
314C-7	Condenser Pumps)	$ 580,000	$ 51,800
314C-3	Chlorine Equipment	18,000	
314C-6	Intake Screens and Sluice Gates	75,000	
	TOTAL CONDENSING AND COOLING WATER SYSTEM	$ 673,000	$ 51,800
	Turbine Instruments and Controls		
314F-1	Turbine Board	$ 35,000	
314F-2	Instruments and Meters	65,000	
	TOTAL TURBINE INSTRUMENTS AND CONTROLS	$ 100,000	

EXHIBIT "A"
URQUHART STATION
(Continued)

CLIENT: SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION: BEECH ISLAND, SOUTH CAROLINA
TITLE: PRELIMINARY ESTIMATE - PROPOSED NEW PLANT

EST. NO. 916-2 (JBF)
W.O. NO. DB-10-22
REV. 8/17/51

F.P.C. Class	Description	60,000 Kw (75,000 Kw Max.) 1450 Psig-1000° - 1000° Reheat-Install at one time 2-Units	Escalation
	Fuel Oil Equipment		
312F-	Meters, Pumps, Tanks (20,000 Gal)	$ 29,500	
	TOTAL FUEL OIL EQUIPMENT	$ 29,500	
	Ash Handling Equipment		
312H	Pumps, Removal System, Sluiceway or Piping System	$ 200,000	
	TOTAL ASH HANDLING EQUIPMENT	$ 200,000	
	Water Supply and Purification System		
312I	Meters, Pumps, Tanks, Purification System	$ 155,000	$ 15,000
	TOTAL WATER SUPPLY AND PURIFICATION SYSTEM	$ 155,000	$ 15,000
	Boiler Instruments and Controls		
312K	Instruments and Controls	$ 225,000	
	TOTAL BOILER INSTRUMENTS AND CONTROLS	$ 225,000	
	Boiler Plant Piping and Insulation		
312L	Piping, Valves, Fittings, Insulation	$1,350,000	
	TOTAL BOILER PLANT PIPING AND INSULATION	$1,350,000	
	TOTAL BOILER PLANT EQUIPMENT	$8,106,700	$ 398,440

R. 1349

EXHIBIT "A"
URQUHART STATION
(Continued)

CLIENT: SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION: BEECH ISLAND, SOUTH CAROLINA
TITLE: PRELIMINARY ESTIMATE - PROPOSED NEW PLANT

F.P.C. Class	Description	60,000 Kw (75,000 Kw Max.) 1450 Psig-1000° - 1000° Reheat-Install at one time 2-Units	Escalation
	Turbine Plant Piping and Insulation		
314G	Piping, Valves, Fitings, Insulation	$ 345,000	
	TOTAL TURBINE PLANT PIPING AND INSULATION	$ 345,000	
	TOTAL TURBINE PLANT EQUIPMENT	$4,976,400	$ 396.010
	STATION ELECTRICAL EQUIPMENT		
315-3	Battery Charging Equipment	$ 3,800	
315-8	Auxiliary Exciter	25,000	$ 2,500
315-16	Lightning Arresters	2,000	
315-18-1	Main Switchooard	75,000	15,000
315-18-2	Load Centers	100,000	10,000
315-19	Neutral Grounding	10,000	
315-21	Capacitors	2,000	
315-22	Storage Battery	6,000	
315-25	Power and Instrument Transformers	170,000	34,000
315-26	Metal Clad Switchgear	900,000	90,000
315-27-1-2-3	Bus, Insulators, Fittings-Tie Bus #2 Unit	120,000	12,000
315-27-4	Cable and Wire	360,000	
315-27-5	Conduit	420,000	
315-28	Air Compressor, Tanks, Piping	9,500	
315-29	Grounding System	30,000	

R-1351

EXHIBIT "A"
URQUHART STATION
(Continued)

CLIENT: SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION: BEECH ISLAND, SOUTH CAROLINA
TITLE: PRELIMINARY ESTIMATE - PROPOSED NEW PLANT
EST. NO. 916-2(JBF)
W.O. NO. DB-10-22
REV. 3/17/51

F.P.C. Class	Description	60,000 Kw(75,000 Kw.Max.) 1450 Psig-1000°-1000° Reheat-Install at one time 2-Units	Escalation
315-30	Structures	$ 15,000	
	TOTAL STATION ELECTRICAL EQUIPMENT	$2,248,300	$ 163,500
	MISC. POWER PLANT EQUIPMENT		
316-1	Air Compressor - General Purpose	Use Soot Blowing Air	
316-5	Communication System	$ 40,000	
316-7	Cranes and Hoists	170,000	$ 16,000
316-8	Fire Protection Equipment	20,000	
316-9	Laboratory Equipment	10,000	
316-12	House Service and Sump Pumps	18,000	1,800
316-13	Machine Shop Equipment	35,000	
316-14	Vacuum Cleaning System	20,000	
316-15	Hospital Equipment		
316-16	Office Furniture and Equipment	18,000	
316-17	Stores Equipment	10,000	
316-20	Miscellaneous Equipment	10,000	
	TOTAL MISC. POWER PLANT EQUIPMENT	$ 351,000	$ 17,800
	SUBSTATION EQUIPMENT (1st Unit 4 Bays, 2nd Unit 5 Bays)		
343-5	Bus, Insulators, Fittings	$ 15,000	
343-6	Cable	15,000	
343-9	Conduit	15,000	

R-1352

EXHIBIT "A"
URQUHART STATI.
(Continued)

CLIENT: SOUTH CAROLINA ELECTRIC & GAS CO.
LOCATION: BEECH ISLAND, SOUTH CAROLINA
TITLE: PRELIMINARY ESTIMATE - PROPOSED NEW PLANT

EST. NO. 916-2 (JBF)
W.O. NO. DB-10-22
REV. 8/17/51

F.P.C. Class	Description	60,000 Kw(75,000 Kw Max.) 1450 Psig-1000° - 1000° Reheat-Install at one time 2-Units	Escalation
343-12	Fence	$ 4,000	
343-18	Lighting System	3,000	
343-19	Lightning Arresters	8,000	
343-20	Manhole	2,000	
343-23	Oil Purifier	2,500	
343-24	Circuit Breakers	75,000	$ 7,500
343-25	Switchboard Panel	3,000	
343-26	Starting-up Transformer	60,000	12,000
343-31	Structures	45,000	
343-32	Disconnect Switches	45,000	
343-33	Oil Storage Tank, Piping, Etc.	15,000	
343-36-1	Power Transformers	505,000	101,000
343-36-2	Instrument Transformers	8,000	1,600
343-36-3	Power and Lighting Transformers	2,500	500
343-39	Supervisory Control	3,500	
343-40	Grounding System	8,000	
343-41	Fire Protection System	25,000	
	TOTAL SUBSTATION EQUIPMENT	$ 859,500	$ 122,600
	G R A N D T O T A L	*$20,345,400	$1,098,350

*Contingencies, Engineering Fees and Interest During Construction are not included in this figure.

EXHIBIT C 1.

URQUHART STATION
SOUTH CAROLINA GENERATING COMPANY

There follows a proposed method of allocation of station operating charges as between the two Initial Units of Urquhart Station and Unit 3 and any subsequent units that may be installed.

Steam Operation - Labor	Chargeable to	Allocation basis**
Supt., Asst. Supt., Results Engr., Shift Supvr., Clerks, etc.	Prod. Supt.*	Units
Control Room Operators - (Units 1 & 2)	Production accounts	1 & 2
	Trans. Sta. Labor	Outgoing Lines
(Unit 3)	Production accounts	3
Turbine Room Operators) Auxiliary Operators) Boiler Tenders)	Production Labor Accounts	Direct
Fuel Handlers	Boiler Labor	Adjusted KWH
	Fuel Stock	Fuel
Ash Handlers	Boiler Labor	Adjusted KWH
Chemists	Prod. Supt.	Units
	Fuel Stock	Fuel
	Water	Units
Janitors, Messengers, etc. General	Misc.Sta.Labor	Units
Special (significant amounts directly assignable)	Misc.Sta.Labor	Direct
Electricians, Machinists, etc. General	Misc.Sta.Labor	Units
Special (significant amounts directly assignable)	Misc.Sta.Labor	Direct
Steam Operation - Supplies & Exp.		
Office Supplies & Expenses	Prod. Supt.*	Units
Fuel	Fuel	Adjusted KWH

(See Page 3 for Note)

Steam Operation - Supplies & Exp.	Chargeable to	Allocation Basis
Water Treatment Supplies		
Purification (chlorine, alum, etc.)	Water	Units
Boiler Water Treatment	Water	Direct
Outside Chemical Analyses	Water	Units
Lubricants		
General	Lubricants	Units
Special (significant quantities, directly assignable, as turbine oil replacement)	Lubricants	Direct
Miscellaneous Supplies		
General	Station Supplies	Units
Special (significant amounts directly assignable)	Station Supplies	Direct
Miscellaneous Expenses		
General	Station Expense	Units
Special (significant amounts directly assignable)	Station Expense	Direct
Steam Maintenance - Labor, Supplies & Exp.		
Structures & Improvements	Same	
Assignable		Direct
Otherwise		Units
Coal Storage, Handling & Weigh.	Same	Adjusted KWH
Furnaces, Boilers & Accessories	Same	Direct
Boiler Apparatus	Same	Direct
Steam Piping & Accessories	Same	
Assignable		Direct
Plant Heating, etc.		Units
Prime Movers & Generators	Same	Direct
Accessory Electric Equipment	Same	
General		Units
Special (significant amounts directly assignable)		Direct
Misc. Power Plant Equip.	Same	
General		Units
Special (significant amounts directly assignable)		Direct

Steam Miscellaneous	Chargeable to	Allocation basis**
Rents***	Same	
Dwellings		Personnel
Other		Function
Transmission (Substation)		
Operation	Various	Outgoing Lines
Maintenance	Various	Direct
Administrative and General		
Salaries of General Officers	Same	Units
Salaries of General Office Emps.	"	"
Expenses of Gen.Office Emps.	"	"
Gen. Office Supplies & Expenses	"	"
Special Services	"	
General		Units
Special (significant amounts directly assignable)		Direct
Legal Services	"	
General		Units
Special (significant amounts directly assignable)		Direct
Regulatory Commission Expense	"	Units
Insurance	"	Direct
Injuries & Damages	"	Units
Employees Welfare Expense	"	"
Pensions	"	"
Miscellaneous General Expense	"	"
General Rents	"	"
Maintenance	"	"

Notes

*Under the accounting system used by the Company all supervision labor, supplies and expenses are charged direct to operations with subsequent transfer to maintenance supervision on the dollar ratio (exclusive of supervision and fuel) of operations to maintenance costs. Hence, only the initial allocations of superintendence items between the first 2 and the 3rd unit is necessary.

**Allocations by "Units" mean 2/3 and 1/3 so long as there are 3 units at the Station.

***Rent income from operators' houses would follow similar allocation.

R.1432
(Rev. 5/23/55)
10h

AVERAGE EARNINGS-PRICE RATIOS AND YIELDS ON THE COMMON STOCK OF ELECTRIC UTILITIES* WITH ANNUAL REVENUES FROM $25,000,000 to $50,000,000 JANUARY 1950 TO DATE

	YEAR											
	1950		1951		1952		1953		1954		1955	
	E.P.R.	Yield	E.P.R.	Yield	E.P.R.	Yield	E.P.R.	Yield	E.P.R.	Yield	E.P.R.	Yield
Jan.	8.9%	5.7%	9.0%	6.0%	7.6%	5.6%	7.4%	5.1%	7.2%	5.3%	6.5%	4.7%
Feb.	8.2	5.5	8.7	5.9	7.6	5.5	7.3	5.1	7.0	5.2	6.2	4.5
Mar.	8.2	5.6	8.9	6.1	7.6	5.5	7.3	5.1	6.8	5.2	6.3	4.6
Apr.	8.2	5.7	8.9	5.9	8.0	5.7	7.7	5.2	6.9	5.1	6.3	4.5
May	8.5	5.6	9.1	6.1	7.7	5.4	8.0	5.5	6.8	5.0		
June	9.2	6.2	9.2	6.2	7.6	5.5	8.3	5.7	6.6	5.0		
July	9.9	6.6	8.6	5.9	7.6	5.4	7.9	5.5	6.2	4.7		
Aug.	9.5	6.3	8.4	5.9	7.4	5.3	7.9	5.6	6.5	4.8		
Sept.	9.2	6.1	8.3	5.9	7.4	5.2	7.9	5.6	6.4	4.7		
Oct.	9.4	6.3	8.3	5.8	7.5	5.3	7.6	5.4	6.8	5.0		
Nov.	9.4	6.3	8.0	5.8	7.4	5.1	7.4	5.4	6.7	4.8		
Dec.	9.0	6.1	7.8	5.7	7.4	5.0	7.3	5.3	6.5	4.7		
Average E.P.R.	9.0%		8.6%		7.6%		7.7%		6.7%			
Yield		6.0%		5.9%		5.4%		5.4%		5.0%		

Notes: The Earnings-Price Ratios are based on the closing market quotations at the end of the month and the latest available earnings for a twelve-months period immediately preceding the end of the month; also, the Earnings-Price Ratios are weighted by the number of common shares of each company which were outstanding at the end of the month.

*Number of companies included: 14 19 19 22 21

Source of Data: Standard & Poor's Stock Guide, Moody's Public Utility Supplements.

R. 1483

SOUTH CAROLINA ELECTRIC & GAS CO. AND SUBSIDIARIES
CAPITALIZATION
DECEMBER 31, 1954

Issue	Amount	Amount	Percent
Long-Term Debt:			
South Carolina Electric & Gas Co.:			
First and Refunding Mortgage Bonds:			
3% Series, 1980	$ 22,200,000		
3% Series A, 1980	4,000,000		
3-3/4% Series, 1981	6,000,000		
4-1/8% Series, 1983	4,000,000		
3% Series, 1975 (South Carolina Power Co.)	8,000,000		
3% Series, 1977 (South Carolina Power Co.)	4,000,000		
3-1/8% Series, 1979 (South Carolina Power Co.)	4,000,000		
Gold Bonds, 5%, 1999 (Charleston Consolidated Railway, Gas and Electric Company)	1,557,000		
Bank Notes, 2-1/2% to 1958	1,762,500		
South Carolina Generating Co.:			
First Mtge. Bonds, 3-7/8%, 1979	19,878,000		
First Mtge. Bonds, 4%, 1981	4,200,000		
Promissory Notes, 4%, 1964	3,496,000		
South Carolina Natural Gas Co.:			
First Mtge. P. L. Bonds, 3-7/8%, 1973	4,000,000		
Total Long-Term Debt		$ 87,093,500	62.8%
Preferred Stock:			
4.50%, $50 par	4,000,000		
4.60%, $50 par	2,765,000		
5%, $50 par	6,261,700		
Total Preferred Stock		13,026,700	9.4
Common Equity:			
Common Stock, $4.50 par	14,178,577		
Premium on Common	9,539,946		
Earned Surplus	7,245,502		
Capital Surplus	7,527,858		
Total Common Equity		38,491,883	27.8
Total Capitalization		$138,612,083	100.0%

Source of Data: Prospectus dated 2/24/55 covering 210,053 shares of common stock.

SOUTH CAROLINA ELECTRIC & GAS CO. AND SUBSIDIARIES
COST OF OUTSTANDING DEBT AND PREFERRED STOCK

(Rev. 5/23/55) R.1484
12

Issue (a)	Date of Issue (b)	Amount of Issue (000) (c)	Out-standing 12/31/54 (000) (d)	Price to Purchaser (000) (e)	Net Proceeds to Company Total (000) (f)	Net Proceeds to Company Per Unit (g)	Net Cost to Company (h)
Long-Term Debt							
S. C. Elec. & Gas Co.							
1st & Ref. Mtge. Bonds:							
3% Series, 1980 4/	4-1-50	$22,200	$22,200	$22,866	$22,575	101.69	2.91%
3% Series A, 1980	12-1-50	4,000	4,000	4,040	4,009	100.22	2.99
3-3/4% Series, 1981	7-1-51	6,000	6,000	6,000	5,947	99.12	3.80
4-1/8% Series, 1983	12-17-53	4,000	4,000	4,000	3,982	99.56	4.15
3% Series, 1975 (S.C.Power Co.) 4/	1-26-45	8,000	8,000	8,110	7,993	99.92	3.00
3% Series, 1977 (S.C.Power Co.) 4/	5-1-47	4,000	4,000	4,120	4,054	101.35	2.93
3-1/8% Series,1979 (S.C.Power Co.)	7-1-49	4,000	4,000	4,000	3,941	98.53	3.20
Gold Bonds,5%,1999 (Charleston Consolidated Ry.,Gas & Elec.Co.)	3-1-1899	2,500	1,557				5.07 1/
Bank Notes, 2-1/2% to 1958	5-28-48	6,200	1,762	6,200	6,118	98.69	2.76
S.C. Generating Co.:							
First Mtge. Bonds, 3-7/8%, 1979	1952-1954	20,000	19,878	20,000	19,836	99.18	3.93
First Mtge. Bonds, 4%, 1981	1954	4,200	4,200	4,200	4,086	97.29	4.17
Promissory Notes, 4%, 1964	1952-1953	4,000	3,496	4,000	3,966	99.14	4.10
S. C. Natural Gas Co.:							
1st. Mtge.P.L.Bonds,3-7/8%, 1973	1954	4,000	4,000	4,200	4,155	103.89	3.59 5/
Total Long-Term Debt			$87,093				3.46%
Preferred Stock							
4.50%, $50 par	1954	4,000	4,000	4,000	3,902	48.78	4.61
4.60%, $50 par	10-3-50	3,000	2,765	3,000	2,907	48.44	4.75
5%, $50 par	1943 2/	6,262	6,262	6,262	2/	2/	5.15 3/
Total Preferred Stock			$13,027				4.90%

1/ In the absence of data .07 was added to coupon rate based on cost of other issues.
2/ Issued 1943 in exchange for Pfd. Stock, Bonds & Debs.
3/ Expense estimated at .15% based on cost of other issues. This 5% series at end of April 1955 was selling at 53 to yield 4.7%. (Standard & Poor's Stock Guide, May 1955).
4/ 3% Bonds due 1975, 1977 and 1980, which are publicly held, were quoted in April 1955 at 94 to yield 3.31% to maturity. (Standard & Poor's Guide, May 1955).
5/ Disregards $313,443 call premium and expense of refunding $4,000,000 and redeeming $500,000 of 4-3/4% bonds before consideration of related estimated Federal income tax reduction of $163,000.

Source: Prospectus 2/24/55, Form No. 1, S.E.C. Publications, data furnished by Company.

R. 19

MONTHLY EARNINGS-PRICE RATIOS OF SOUTH CAROLINA ELECTRIC & GAS COMPANY COMMON STOCK JANUARY 1950 TO DATE

	Earnings-Price Ratios					
	1950	1951	1952	1953	1954	1955
January	12.8%	8.9%	4.7%	7.4%	6.7%	7.2%
February	13.2	9.4	4.8	7.1	7.1	6.8
March	12.8	9.7	4.6	6.4	7.1	
April	13.6	7.8	6.0	6.0	7.3	
May	11.4	7.7	6.1	6.1	6.6	
June	12.8	8.1	6.1	6.5	7.1	
July	13.4	8.6	5.5	6.7	7.1	
August	12.1	7.0	5.9	6.6	7.2	
September	11.5	6.9	5.8	6.7	6.9	
October	12.1	6.4	6.8	6.4	7.9	
November	9.8	6.4	6.7	6.5	7.7	
December	9.5	6.0	6.6	6.4	7.4	
Straight Average	12.1%	7.7%	5.8%	6.6%	7.2%	

Notes: The above data are based on the closing market quotations at the end of the month and the latest available earnings for a twelve-months period immediately preceding the particular month.

Source of Data: Moody's Public Utility Cummlative Index, Standard & Poor's Stock Guide and Bank and Quotation Record.

OFFERINGS OF COMMON STOCK BY SOUTH CAROLINA ELECTRIC & GAS CO.
1948 TO DATE

Date of Record (a)	Size of Offering: No. of Shares (b)	Size of Offering: Amount (Millions) (c)	Offering Ratio One For: (d)	Percent Subscribed (e)	Offering Price Per Share (f)	Net Proceeds to Company: Total (g)	Net Proceeds to Company: Per Share (h)	Latest Published Earnings Per Share: 12 Mos. Ended (i)	Latest Published Earnings Per Share: Amount (j)	Offering Price Ratio (k)	Net Offering Price Ratio (l)	Market Price Prior to Offering: Date (m)	Market Price Prior to Offering: Price (n)	Relation of Offering Price to Market Price (o)
5/11/48	404,293	$2.6	2	61%	$ 6.50	$2,343,799	$ 5.80	3/31/48	$1.13	17.4%	19.5%	5/8/48	$7.125	91.2%
5/13/49	310,150	2.4	4	78	7.625	2,210,026	7.13	3/31/49	1.29	16.9	18.1	5/11/49	8.125	93.8
4/15/52	417,719	4.0	5	58	9.625	3,790,286	9.07	2/29/52	0.57	5.9	6.3	4/12/52	9.875	97.5
2/18/53	358,045	4.3	7	100	12.00	4,135,848	11.55	12/31/52	0.90	7.5	7.8	2/16/53	12.875	93.2
2/17/54	286,436	4.2	10	100	14.75	4,075,829	14.23	12/31/53	1.15	7.8	8.1	2/15/54	16.00	92.2
2/24/55	210,053	3.7	15	100	17.50	3,654,922	16.90	12/31/54	1.33	7.6	7.9	2/21/55	18.875	92.7

Notes: All issues of Common Stock have been made to stockholders under rights and were underwritten.

Source of Data: F.P.C. Form No. 1, Wall Street Journal, Moody's Public Utilities Supplements, Prospectus.

Ex. 28
R. 1543

SOUTH CAROLINA GENERATING COMPANY
Estimate of Revenue Deductions
Georgia Power Company Contract

	First Year	Fifth Year
Depreciation:		
Plant Cost	$ 26,682,000	
Less Non-depreciable Items	163,500	
Depreciable Base	$ 26,518,500	
Less Transmission Line to Georgia	35,000	
Net Plant	$ 26,483,500	
Georgia Portion of Plant (50%)	$ 13,241,800	
Plus Transmission Line to Georgia	35,000	
Depreciable Base applicable to Georgia	$ 13,276,800	$ 13,276,800
Annual Depreciation @ 2.75%	$ 365,112	$ 365,112
State Income Tax on Fringe:		
Revenue from Fringe	$ 540,000	$ 540,000
State Income Tax @ 4.5%	$ 24,300	$ 24,300

RES
3-5-54

Ex. 35 R. 1566

STATE OF SOUTH CAROLINA)
) CONSTRUCTION OF TRANSMISSION FACILITIES
COUNTY OF RICHLAND) AND AGREEMENT TO BACK UP

WHEREAS, on the 13th day of November, 1951, the South Carolina Electric & Gas Company, hereinafter sometimes called "Electric & Gas", and the South Carolina Generating Company, hereinafter sometimes called "Generating Company", both of which are corporations organized and existing under and by virtue of the laws of the State of South Carolina, entered into an agreement for the sale by Generating Company and the purchase by Electric & Gas of certain capacity and energy from the Urquhart Station of the Generating Company; and,

WHEREAS, the said agreement of November 13, 1951, fully set forth and delineated a description of the Urquhart Station, hereinafter sometimes referred to as "Station", the terms and conditions of the said purchase, and all other pertinent requisites, the principal capacity purchased by Electric & Gas being "KW Contract Demand", as defined in §2.03 of the November 13th agreement of 75,000 KW of electric capacity, or a portion thereof remaining after the exercise of certain rights reserved to Generating Company under Article IV of the November 13th agreement; and,

WHEREAS, the Generating Company entered into a Letter Contract dated January 11, 1952, with E. I. duPont de Nemours & Co., a corporation organized and existing under the laws of the State of Delaware, prime contractor under contract AT(07-2)-1 with the Atomic Energy Commission, hereinafter known as AEC, an agency

of the United States government, which letter was concurred in and accepted by Electric & Gas; and,

WHEREAS, the said Letter Contract provided, among other things, for certain transmission facilities to be constructed by Electric & Gas, and certain other actions to be taken by Electric & Gas; and,

WHEREAS, it is necessary and desirable to more fully effectuate the terms of the said Letter Contract, and the contract which is to be entered into in lieu thereof, to effectuate an agreement between Electric & Gas and Generating Company concerning the said transmission facilities, and other matters.

NOW, THEREFORE, for and in consideration of the mutual covenants and agreements herein contained, the same to be well and truly kept and performed, the said parties hereto, Electric & Gas and Generating Company, for themselves, their successors and assigns, hereby agree with each other as follows:

ARTICLE I
TRANSMISSION FACILITIES

§1.01 Construction: Electric & Gas will proceed expeditiously with the design, construction, operation and maintenance of a single 115 KV transmission line running from the 115 KV switch yard of the Generating Company at the Station to a 115 KV switch yard located on the Savannah River Project of the AEC. This line will be completed on or before January 1, 1954.

§1.02 Use: It is understood and agreed between the parties that the transmission line to be constructed by virtue

of this Article shall be used solely to transmit electric capacity and energy between Urquhart Station and the Savannah River Project, and that Electric & Gas will transmit electric capacity and energy over the same as may be presented by Generating Company for delivery to and accepted by, duPont in accordance with the said Letter Contract, or any contract, or amendment thereto, concurred in and signed by Electric & Gas.

§1.03 Payment: As a charge for such transmission, Generating Company will pay to Electric & Gas annually, in equal monthly installments, an amount equal to 15% of the total cost of the said transmission line.

ARTICLE II
CHANGES IN SYSTEM OF ELECTRIC & GAS

§2.01 Changes: Electric & Gas will proceed expeditiously to make the changes and improvements in its system as outlined in its schematic diagram SS 2217 dated September 18, 1951, excluding the switch yard of the Generating Company located at Urquhart Station, such changes being fully shown and delineated in Exhibit "A" hereto annexed.

§2.02 Interconnections: Electric & Gas will also establish, or cause to be established, an interconnection, or interconnections between the Station and the system of Electric & Gas.

ARTICLE III
CAPACITY AND ENERGY TO BE MADE AVAILABLE
BY ELECTRIC & GAS

§3.01 Back-up: Electric & Gas will make available to

Generating Company at the Station's 115 KV bus any amount of capacity and energy needed by Generating Company to fulfill its agreement with duPont for energy supplied to the Savannah River Project pursuant to the aforesaid Letter Contract of January 11, 1952, or any contract replacing the same concurred in and signed by Electric & Gas, provided, however, that in no event shall Electric & Gas be required to make available capacity in excess of 30,000 KW.

It is specifically understood and agreed, however, that Electric & Gas shall be required to make this capacity and energy available only because of failures due to breakdowns, outages, necessary repairs, etc. and only on a temporary basis, and, further , that it shall not be required to make such capacity and energy available during any period of outage or breakdown which is not reckoned or counted as part of the time during which the contract deliveries are to be made by virtue of any force majeure clause in the contract between duPont and Generating Company for the delivery of capacity and energy thus backed-up.

§3.02 Force Majeure: Electric & Gas shall not be required to deliver or make available any of the said electric capacity and energy as above set forth in §§1.02 and 3.01 if it is prevented by reason of or through strike, stoppage in labor, failure of contractors, suppliers of material, riot, fire, flood, ice, invasion, civil war, commotion, insurrection, military or usurped power, order of any Court or Judge granted in any bona fide adverse legal proceedings or action, order of any civil authority, or

military, either de facto or de jure, explosion, act of God, or the public enemies, or any cause reasonably beyond its control.

§3.03 Energy Charge: The energy charge for all energy delivered under §3.01 of this Article shall be the weighted average fuel cost for all of Electric & Gas's fuel plants for the month during which such energy is supplied, plus 15%.

§3.04 Metering: All energy delivered to Generating Company by virtue of §3.01, above, by Electric & Gas, shall be metered at the Generating Company's 115 KV Station bus.

ARTICLE IV
TERM AND CANCELLATION

§4.01 Term: This contract to become effective upon the date of signing and continue in full force and effect for a period of twenty-five (25) years from the date the second generating unit at Urquhart Station goes into commercial operation, provided, that the payment of the transmission charges, as delineated in Article II, shall begin immediately upon completion of the line or the readiness of the first unit for commercial operation, whichever date is the later, but not before January 1, 1954, and provided, further however, that Generating Company may cancel this agreement upon the giving of one (1) years notice in writing to the Electric & Gas Company and upon the payment to Electric & Gas of the charges hereinafter set forth in §4.02.

§4.02 Cancellation Charges: The cancellation charges herein stated are in the terms of annual charges for the transmission line as set forth in §2.03 of Article II hereof, as set

forth above. In other words, if the cancellation charge is made during the first year, the charge will be 175% of such annual charge; if the cancellation is made during the second year, the charge will be 168% of such annual charge and so on until if the cancellation is made during the 14th year, the charge will be 100% of such annual charge. For the purpose of this section, the first year is to be considered as covering the period from the date of the contract through the end of the first full calendar year during which power is delivered by Generating Company to duPont for the operation of the Savannah River Project.

1st Year	1.75	2nd Year	1.68	3rd Year	1.57
4th Year	1.51	5th Year	1.47	6th Year	1.43
7th Year	1.35	8th Year	1.28	9th Year	1.20
10th Year	1.16	11th Year	1.12	12th Year	1.09
13th Year	1.06	14th Year	1.00	No charge after the 14th year.	

IN WITNESS WHEREOF the parties hereto have caused these presents to be signed in their respective names by the officers hereunder indicated, and attested to by their respective secretaries, and their respective seals thereto affixed by such respective Secretaries, this 31st day of March, 1954.

SOUTH CAROLINA ELECTRIC & GAS COMPANY

ATTEST:

/s/ L. F. Pearce
Secretary

By /s/ S. C. McMeekin
President

SOUTH CAROLINA GENERATING COMPANY

ATTEST:

/s/ L. F. Pearce
Secretary

By /s/ F. R. McMeekin
Vice President

Exhibit A to Rate Schedule
F.P.C. No 1 (Item A) R.1720

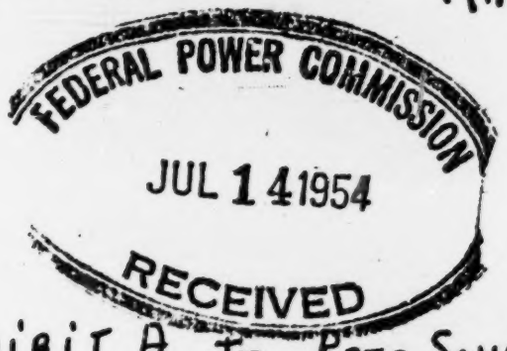

Exhibit A to Rate Schedule
F.P.C. No. 1 (Item A)
R. 1720

POWER CONTRACT

BETWEEN

SOUTH CAROLINA GENERATING COMPANY

AND

SOUTH CAROLINA ELECTRIC & GAS COMPANY

This Agreement, made and entered into on this 13th day of November, 1951, by and between South Carolina Electric & Gas Company, a corporation organized and existing under the laws of the State of South Carolina, hereinafter sometimes called "Electric & Gas", South Carolina Generating Company, a corporation organized and existing under the laws of the State of South Carolina, hereinafter sometimes called "Generating Company", and The First National Bank of South Carolina of Columbia, a banking corporation organized and existing under the laws of the United States, hereinafter sometimes called the "Bank",

WITNESSETH, THAT:

WHEREAS, Generating Company proposes to construct a steam electric generating station on the South Carolina side of the Savannah River at or near Beech Island, southeast of Augusta, Georgia, which will have a capacity of 150,000 KW, consisting of a first 75,000 KW unit which is planned to be in operation by March 1, 1953, and a second 75,000 KW unit which is planned to be in operation by July 1, 1953, subject to delays beyond the control of Generating Company; and

WHEREAS, Electric & Gas is desirous of purchasing electric capacity and energy from the Urquhart Station of Generating Company, under the terms and conditions hereinafter set forth; and,

WHEREAS, it is contemplated that this agreement will be pledged as collateral security by the Generating Company to Mellon National Bank & Trust Company, as Trustee, under an Indenture to be executed, to secure First Mortgage Bonds of Generating Company; and,

WHEREAS, this Agreement is the agreement referred to in Paragraph 2 A (g) of defined Purchase Agreement between Generating Company, Electric & Gas Company and The Northwestern Mutual Life Insurance Company and the Bond Purchase Agreement between Generating Company, Electric & Gas and Metropolitan Life Insurance Company.

NOW, THEREFORE, in consideration of the covenants and agreements hereinafter contained, the electric capacity and energy to be delivered and

the sums of money to be paid, said parties hereto for themselves, their successors and assigns, hereby agree with each other as follows:

ARTICLE I
FACILITIES TO BE PROVIDED

Section 1.01 Generating Station: Generating Company will proceed expeditiously with the design, purchase and construction, and operation and maintenance of its Urquhart steam electric generating station, to consist of two 75,000 KVA, 60,000 KW, 0.8 P.F. at 0.5 p s i hydrogen pressure turbo-generators (manufacturer's name plate rating), together with necessary auxiliary equipment, step-up substation and switching facilities, at the location described above, said station and additional facilities being sometimes hereinafter referred to as the "Urquhart Station", or "Station", and Generating Company hereby agrees to exert its best efforts to have the first unit in commercial operation not later than March 1, 1953, and the second unit in commercial operation not later than July 1, 1953.

Section 1.02 Description of Station: A description of the Urquhart Station, together with estimated costs of construction, is contained in Exhibit "A" hereto attached and made a part hereof. Generating Company agrees that it will make no substantial departure from plans for such Station as in said Exhibit set forth, unless agreed to by Electric & Gas.

Section 1.03 Scope of Agreement: All provisions of this agreement shall have reference only to the Urquhart Station as described in Sections 1.01 and 1.02 and Exhibit "A" except where otherwise specifically stated.

Section 1.04 Construction of Additional Capacity: Generating Company may, if it so desires, increase the generating capacity of the

Urquhart Station by adding a unit or units in addition to those described in Sections 1.01 and 1.02 and Exhibit "A" but any such additions shall not affect this agreement except to the extent herein specifically provided.

Section 1.05 Portion of Capacity of Urquhart Station allocated to Electric & Gas: Of the 150,000 KW capacity of the Urquhart Station, 75,000 KW is allocated to Electric & Gas, subject to the provisions hereinafter set forth.

Section 1.06 Maintenance of Turbo-Generators, Boilers and Accessory Equipment: Generating Company agrees to maintain its turbo-generators, boilers, condensers and accessory equipment essential to the operation of Urquhart Station throughout the term of this agreement in such manner as to insure operation of all such equipment at full load, except during periods of outages for inspection and maintenance, or as a result of failure of such equipment. Such outages for inspection and maintenance shall be mutually agreed upon, it being the intention of the parties that such equipment shall be taken out of service for this purpose at times when it is least likely to be needed in service. In event of failure of any such equipment, Generating Company agrees to replace or repair such equipment so as to restore it to service as quickly as possible.

Section 1.07 Delivery Equipment: All necessary apparatus at Urquhart Station, such as high voltage switches, metering, communication, telemetering, protective and load control equipment required to deliver electric capacity and energy as herein provided shall be installed by Generating Company.

Section 1.08 Insurance: Generating Company shall carry insurance

to protect the Station from loss or damage, and to protect Generating Company against claim of or damage to employees, other persons or property, the insurance to be carried to be that regarded as proper and reasonable by electric utility operating companies. Generating Company agreed to furnish annually its insurance program to Electric & Gas. The cost of such insurance shall be included in expenses used in determining the capacity charge.

ARTICLE II
USE OF FACILITIES AND DELIVERIES OF POWER

Section 2.01 Delivery Point: Electric capacity and energy shall be delivered to Electric & Gas at the Station's substation, at which point or points title and possession of such electric capacity and energy shall pass to Electric & Gas. Such point or points are hereby designated and hereinafter referred to as the "delivery point".

Section 2.02 Metering: Metering of the electric capacity and energy to be delivered to Electric & Gas herein referred to shall be at the Urquhart Station substation at approximately 115 KV.

Section 2.03 KW Contract Demand: The term "KW Contract Demand" shall mean 75,000 KW of electric capacity or that portion thereof remaining after the exercise of the rights reserved to Generating Company under Article IV. At all times Generating Company agrees to deliver to Electric & Gas and Electric & Gas agrees to accept at the delivery point, its then KW Contract Demand, or any portion thereof scheduled by Electric & Gas, provided, however, that for the period between the date the first unit in the Urquhart Station goes into commercial operation and the date the second unit in such station goes into commercial operation, or in the event that the electric capacity of the Urquhart Station shall be reduced due to failure of equipment,

or outage for maintenance or inspection of equipment therein, or any cause beyond the control of Generating Company, the portion of the available electric capacity to be delivered to Electric & Gas, shall be in the same proportion as its then KW Contract Demand bears to 150,000 KW.

If at any time Electric & Gas desires to increase its KW Contract Demand, it may so notify Generating Company, such notice to be in writing, and Generating Company shall forthwith proceed to reduce the KW Contract Demand available to other customers by an amount or amounts necessary to fulfill the increased KW Contract Demand specified by Electric & Gas, insofar as, and as expeditiously as, agreements with the said other parties permit. Should Generating Company reduce the KW Contract Demand of any other customer pursuant to such notice in writing or for any other cause after notice to and agreement by Electric & Gas, both such notice and agreement to be in writing, or should any customer or other party having KW Contract Demand from the Station reduce or cancel the same or should any KW Contract Demand from the Station be reduced or cancelled for any cause, then Electric & Gas shall have the right and be obligated immediately to assume the same; provided, however, that if any contracting party cancels or reduces any KW Contract Demand which it is not legally entitled to so reduce or cancel, then Generating Company shall take any legal or other action available to it as to that portion of such reduced or cancelled demand which Electric & Gas does not desire to assume.

Section 2.04 KVA Demand: Electric & Gas shall be entitled to take KVA from the Urquhart Station up to the same pro-rata part of the total KVA available from the Station as the then KW Contract Demand of Electric & Gas bears to 150,000 KW. In event Electric & Gas desires to schedule KW deliveries

below its KW Contract Demand, it may take the full amount of reactive KVA made available by such reduction in its KW receipts. In event Electric & Gas desires more reactive KVA than may be available to it under either of the above conditions, and should Generating Company, at its sole option, agree to make available such additional amount, or any portion thereof, payment by Electric & Gas for such excess shall be on a reasonable basis by mutual agreement.

Section 2.05 Minimum KW Demand: Unless Generating Company agrees in advance, the minimum KW demand that Electric & Gas may schedule shall not be less in relation to its then KW Contract Demand than the minimum safe load, as determined by the parties hereto, of the Station generating units in operation bears to 150,000 KW, unless notice is given by Electric & Gas that no capacity and energy will be demanded for a period sufficient, under good operating and engineering practices, to allow a unit to be safely closed down for such period of no demand and started up thereafter. This minimum KW demand requirement shall not apply when the total load on the portion of the Station generating units in operation is in excess of minimum safe load; provided, however, that for any portion of Electric & Gas' share of minimum load not taken by it, Electric & Gas shall pay to Generating Company five per cent (5%) of the fuel cost required to generate Electric & Gas' share of minimum load not actually taken by Electric & Gas, based upon the average fuel cost and average fuel efficiency during the month involved.

In the event the conditions provided for in the preceding sentence are reversed and the other load of Generating Company is less than the prorata portion of the minimum safe load of the Station available for operation, and such deficit is taken by Electric & Gas, then five per cent (5%) of the

fuel cost, based on the average fuel cost and average fuel efficiency during the month involved, required to generate Generating Company's other customers' share of the minimum safe load not taken by such other customers shall be deducted from the energy charge to Electric & Gas for the month involved.

Section 2.06 Character of Capacity and Energy: The electric capacity and energy to be furnished hereunder shall be of the character commonly known as three-phase alternating current at approximately 60 cycles per second and at a nominal voltage of 115 KV.

Section 2.07 Other Equipment: If Electric & Gas desires special 115 KV voltage regulating, communication or control apparatus at the Station for use in connection with the delivery and receipt of electric capacity hereunder, Generating Company agrees to provide space for the installation of such apparatus. Representatives of Electric & Gas shall at all times have access to the premises of Generating Company's Urquhart Station for the purpose of inspection and maintenance of such apparatus. Electric & Gas may at any time at its option and expense remove any of the facilities installed under this Section 2.07 from Generating Company's property.

ARTICLE III
RATES AND CHARGES

Section 3.01 Basis: Payment for capacity and energy delivered to Electric & Gas shall be made monthly on the basis of a capacity charge plus an energy charge.

Section 3.02 Capacity Charge: The capacity charge, except as is described in Section 3.02 (e) for certain capacity and energy, shall be at the rate of fifteen dollars and thirty cents ($15.30) per kilowatt-year on the then KW Contract Demand of Electric & Gas hereunder, starting when the first unit is ready for commercial operation, subject to adjustment as follows:

(a) For any fraction of a year, the capacity charge shall be determined thus: For each calendar month, one-twelfth of the annual capacity charge; and for each part of a calendar month, that proportion of one-twelfth of the annual capacity charge which the part of the calendar month under consideration bears to the whole of said month.

(b) The base rate of the capacity charge has been calculated to include certain fixed charges for financing, such as interest, amortization and eight per cent (8%) return on equity capital, the total of which will amount to $1,576,240 per year based on an estimated total expenditure as follows:

For Plant Cost	$23,400,000
For Working Capital, including coal stocks	1,000,000
	$24,400,000

[illegible] cost shall consist of the cost of the direct production facilities, the step-up substation and switching facilities at the Station, and any related general plant investment, all as defined by the Federal Power Commission Uniform System of Accounts prescribed for Public Utilities and Licensees as in effect at the date hereof (hereinafter called the "Uniform System of Accounts").

Working capital shall consist of the investment in materials and supplies applicable to the ownership and operation of the Station and properly includable in Account 131.1 of the Uniform System of Accounts, including coal stocks not in excess of 100,000 tons, plus an amount equal to one-sixth of the total annual operating expenses, excluding taxes, depreciation and amortization, of Generating Company which are applicable to the ownership and operation of the Station as shown on the books of Generating Company.

The estimated annual fixed charges of $1,576,240 amount to approxi-

mately $10.50 per kilowatt based upon 150,000 KW capacity. In the event the total expenditure for items shown in this Section 3.02(b) exceeds the estimated total of $24,400,000, the capacity charge shall be increased at the rate of one (1) cent per KW-year for each one-tenth of one per cent (1/10%) increase in such total expenditure. In event such total expenditure is less than $24,400,000, the capacity charge shall be decreased at the rate of one (1) cent per KW-year for each one-tenth of one per cent (1/10%) decrease in such total expenditure.

The adjustment in capacity charge provided in the preceding paragraph, in so far as it is affected by plant cost, shall be determined as soon as such final expenditure figures are available, but not more than twelve (12) months after the second unit is placed in commercial operation, and shall be retroactive to the date electric capacity and energy is first delivered to Electric & Gas hereunder.

The adjustment in capacity charge provided for in the second preceding paragraph, insofar as it is affected by working capital, shall be determined at the beginning of each calendar year, applicable for the ensuing calendar year, as the average of the month-end balances during the preceding calendar year of the investment in materials and supplies as defined above, plus an amount equal to one-sixth of the operating expenses for the preceding calendar year as defined above; provided, however, that for the period between the beginning of commercial operation and the end of the first full calendar year thereafter, working capital shall be considered as $1,000,000, subject to retroactive adjustment for any difference between such estimate and the working capital as computed in accordance with the above procedure.

In case additional expenditures applicable to the plant cost of the

Station are made during the term of this agreement by Generating Company to improve efficiency, to utilize other fuels, to replace equipment, including replacements occasioned by casualties not reimbursed by insurance or otherwise, or for other purposes to be mutually agreed upon, such expenditures shall be added to those set forth above, in this Section 3.02(b), provided that such expenditures are chargeable to Plant Account under the Uniform System of Accounts, and the capacity charge shall be adjusted at the end of each month in accordance with the formula set forth above, to apply from the beginning of the ensuing month; provided, however, that no expenditures applicable to any particular improvement or addition costing in excess of $100,000 shall be considered in adjusting the capacity charge unless such expenditures shall have been authorized by Electric & Gas.

(c) The total capacity charge also includes expenses related to the ownership of the Urquhart Station, the maintaining of an operating organization, and the performance of all corporate, legal, administrative and general functions which may be appropriate in the premises, in a total estimated annual amount of $720,000 for such expenses, including taxes other than those covered in Section 3.03. These annual expenses have been estimated as follows:

1.	Federal, State and Local Taxes	$460,000
2.	Administrative and General Expense	60,000
3.	Operating Supervision and Labor	200,000
		$720,000

The above expenses are limited to those applicable to the ownership and operation of the Station and chargeable under the Uniform System of Accounts to Account 507, and the accounts for Production Expenses, Transmission Expenses, and Administrative and General Expenses, exclusive of those

amounts covered in Section 3.03.

These estimated annual expenses of $720,000 amount to approximately $4.80 per KW based upon 150,000 KW capacity. In event these annual expenses, actual or computed as herein provided, exceed the estimated total of $720,000 for any calendar year, the capacity charge shall be increased at the rate of one cent per KW-year for each two-tenths of one per cent (2/10%) increase in such total expenses. In event these expenses for any calendar year fall below $720,000, the capacity charge shall be decreased at the rate of one cent per KW-year for each two-tenths of one per cent (2/10%) decrease in such total expenses.

Taxes shall be included in the determination of the annual expenses in this sub-section 3.02(c) for the purpose of establishing the adjustment in the preceding paragraph, to the extent and in the manner prescribed in Section 3.04.

The adjustment in capacity charge provided for above in this Section 3.02(c) shall be made as soon as possible after the close of each calendar year, and shall be retroactive to the beginning of said calendar year; and such adjusted annual rate of capacity charge shall become the basis of billing during the ensuing calendar year, subject to adjustment as above at the end of such calendar year. Nothing herein shall prevent the parties hereto from agreeing upon a further adjustment in rate for any or all of the intervening months, subject to the year-end adjustment herein provided.

(d) If, however, at the end of any full calendar year or earlier period if necessary the total income of Generating Company, after payment of operating and other necessary expenses, and taxes, shall be insufficient to provide Generating Company with funds adequate to pay interest on and amortize

the debt incurred in the construction of the Station as above set forth and delineated, and to have left 8% return on its equity investment, then the capacity charge per kilowatt year for that calendar year shall be retroactively increased by an amount determined by dividing the amount of money necessary to be added to the income of Generating Company to service the debt and have 8% return on its equity investment, as above described, by the annual KW Contract Demand of Electric & Gas in effect for such year. When the annual KW Contract Demand of Electric & Gas has varied during this period, then the divisor shall be the average KW Contract Demand of Electric & Gas for that calendar year. The monies due under such method of adjustment shall be determined as soon as practicable at the end of each calendar year where necessary, and Electric & Gas shall pay the bill for same, duly presented, under and in accordance with the provisions of Article V of this agreement.

(e) For any electric capacity which Generating Company recaptures from any other company at the request of Electric & Gas and delivers the same to Electric & Gas, all pursuant to the provisions of Section 2.03 hereof, then Electric & Gas shall pay for such electric capacity at the same rate as the customers from whom the same is recaptured would have paid for it.

(f) During the period commencing when the first unit is ready for commercial operation and ending when the second unit is ready for commercial operation, the capacity charge payable hereunder shall be determined by applying the annual rate, determined in accordance with Section 3.02, to one-half of the then KW Contract Demand.

Generating Company shall advise Electric & Gas in writing the date on which each unit shall be ready for commercial operation.

Section 3.03 Energy Charge: The energy charge, for energy furnished each month under the provisions of this agreement, shall be (1) a proportionate part of Generating Company's expenses for fuel and maintenance not reimbursed by insurance which are applicable to the Station and are properly chargeable to Accounts 703, 706, 707, 708, 709, 747, 748, 749, 750 and 751 of the Uniform System of Accounts, in the proportion for such month as the kilowatt-hours taken by Electric & Gas, plus associated step-up transformer losses to be determined from manufacturer's test data and other related factors, bear to the total net kilowatt-hours generated by the Station, plus (2) any taxes associated with or attributable to transactions or charges under this Section 3.03, to the extent and in the manner prescribed in Section 3.04.

To avoid possible inequities in the foregoing proportionate determination of maintenance expense entering into the energy charge month by month, an adjustment of such energy charge shall be made at the end of each calendar year so that Electric & Gas shall, for such annual period, pay that proportion of the total maintenance expense for such period as the kilowatt-hours taken during such annual period by Electric & Gas, plus associated step-up transformer losses, bear to the total net kilowatt-hours generated during such annual period by the Station. Net kilowatt-hours generated is defined as total gross generation of the Station, less energy required in the operation of the Station.

If Generating Company increases the generating capacity of the Station as provided in Section 1.04, the fuel costs used in determining the energy charge shall be based on the average cost of all fuels used by all units in the plant.

Section 3.04 Taxes:

(A) Energy Charge: The tax component to be included with other expenses for allocation (in the ratio of kilowatt-hours) in the energy charge, under Section 3.03, shall:

(1) Include only such taxes as are affected by the volume of output of electric energy from the Station or activities or transactions related thereto, such as all taxes, licenses and levies which are or may be levied, or imposed upon or payable by Generating Company by reason or on account of the production, generation, transmission, sale or delivery of electric energy, including taxes on the purchase, use, delivery or other transactions or events relating to fuel used in the production of electric energy (to be accounted for and charged for as a component of fuel cost) and relating to materials, supplies and equipment used in maintaining the Station (to be accounted for and charged for as a component of maintenance cost), and all taxes on or measured by gross receipts or gross revenues realized from the energy charge under Section 3.03, excluding, however,

(a) all taxes, licenses and levies measured by or imposed on net income, net operating income, or excess profits; and

(b) all payroll and employment taxes; and

(2) Be in an amount equal to all taxes covered by Section 3.04 (A)(1), including any pyramiding of such taxes which shall result from the inclusion of the tax component in the receipts or revenues to be derived from the energy charge under Section 3.03.

(B) Capacity Charge: The tax component to be included, in lieu of the estimated annual taxes of $460,000, in determining the total annual expenses for allocation (in substantially the ratio of contract demand to Station

capacity) in the capacity charge, by means of adjustments prescribed in Section 3.02(c), shall:

(1) Include all taxes, licenses and levies which are or may be levied, or imposed upon or payable by Generating Company except to the extent that the amount of any tax has been included in the tax component in Section 3.04 (A) or is chargeable to Plant Account under the Uniform System of Accounts, and

(2) Be in an amount equal to all taxes covered by Section 3.04 (B)(1), including any pyramiding of such taxes which shall result from the inclusion of the tax component in the receipts or revenues to be derived from the capacity charge under Section 3.02(c).

(C) Taxes on Income: In determining the amount of any tax on or measured by net income, net operating income or excess profits, to be included in the tax component pursuant to the provisions of Section 3.04(B), the following adjustments shall be made:

(1) The gross base or measure of such tax shall be limited to the gross revenues of Generating Company from the energy charge and the portion of the capacity charge referred to in Sections 3.02(b) and 3.02 (c) payable by Electric & Gas and amounts in respect of the same items payable by any other purchaser of power from Generating Company. In the event the charges of Generating Company to any purchaser of power on account of the energy charge and the items included in the portion of the capacity charge referred to in Sections 3.02(b) and 3.02(c) hereof, should be at rates greater or less than the charges on account thereof made to Electric & Gas for the same period, there shall nevertheless be included in the gross base or measure of the taxes referred to in this

Section 3.04 (C)(1) an amount on account of such sales based on the rates charged Electric & Gas for said period, determined in the case of the energy charge on a per KWH basis and in the case of the capacity charge on the basis of the charge per KW year of KW Contract Demand.

(2) In the case of any such tax in respect of which depreciation and interest shall be allowed as deductions, the amortization and interest included in any taxable period in the financing charges under Section 3.02(b), computed as 87.6161% of the capacity charge made under Section 3.02(b), shall be substituted and used in lieu of the depreciation and interest allowed as deductions to Generating Company for such taxable period in determining such tax, provided, however, that in the case of any tax in respect of which either depreciation or interest (but not both said items) shall be disallowed as a deduction, such amortization or interest included in said financing charges shall be substituted and used in lieu of depreciation allowed or the interest allowed, as the case may be, in determining such tax.

(3) There shall not be taken into account deductions and losses attributable to debt retirmenet, refinancing, casualties and abandonments, and other expenses or deductions not attributable to or used in determining the charges to Electric & Gas under Sections 3.02(c) and 3.03, and the carry-over and carry-back of losses, deductions, unused credits and other adjustments.

(4) The amount of such tax liabilities shall be determined on a return separate basis.

(D) Exemptions, Apportionment and Preferential or Discriminatory Taxation: In the event that a portion of the gross revenues, property, purchase price or

other base or measure of any tax shall be exempt from any tax due to the nature of the use or ownership of property, or the exempt character of the transaction, or the exempt nature of the purchaser or user, or purchase or use, of electric energy or similar exemptions (or shall be reduced by allocation or apportionment), such tax shall, in determining the amount thereof to be included in the tax component pursuant to the provisions of Section 3.04(A) and 3.04(B), be computed as if the entire measure of Generating Company's base for such tax for the taxable period is exempt (or is reduced by allocation or apportionment) in the proportion that the measure thereof applicable to transactions or dealings with or receipts from or otherwise attributable to Electric & Gas shall be exempt (or shall be reduced by allocation or apportionment), provided, that in the case of graduated rates, the average rate shall be applied to the said base or measure, as provided in Section 3.04(E).

This Section 3.04(D) shall apply to preferential, discriminatory or special taxation applied to particular persons, property or transactions, but shall not apply to general exemptions such as the elimination from the base of a tax of a minimum amount of revenues or income.

(E) Graduated Rates: In determining the amount of any tax, other than taxes on or measured by net income, net operating income or excess profits, to be included in the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B), each such tax shall be deemed to be imposed at a level average rate, which shall be the effective rate of such tax as applied to the entire measure of Generating Company's base for such tax for the taxable period.

(F) Applicable Tax Period: In determining the amount of any tax to be

included in the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B), such taxes shall be determined by reference to the base or measuring period, it being the intention of the parties that in the event a tax is imposed on a privilege, franchise, or other subject for a period which differs from the period by which the base or measure thereof is determined, the tax shall be deemed, for purposes of this agreement, to be applicable with respect to the base or measuring period.

(G) Deductible Taxes: If, in computing the amount of any tax, another tax is deductible or may be offset or credited, the amount thereof to be considered deductible, offset or credited, in determining the tax component to be included pursuant to the provisions of Sections 3.04(A), and 3.04 (B), shall be subject to the provisions of Sections 3.04(C), 3.04(D), 3.04(E) and 3.04(F).

(H) Adjustments for Prior Years: The determination of the amount of any tax included in the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B) for any prior year shall be subject to adjustment in respect of any tax applicable to such year at the time such tax is subsequently required to be paid to a taxing authority by Generating Company and also upon the final determination of the amount of such tax liability made by Generating Company with the taxing authority, whether by settlement, litigation or otherwise. The amount of the tax component for such prior period shall be recomputed as provided by this Section 3.04 so as to consider, where applicable, the amount of such taxes so to be paid, or as thus finally determined, together with any interest and penalties thereon. Electric & Gas shall promptly pay to Generating Company the amount of the additional energy and capacity charges payable for said period, as thus recomputed, and

Generating Company shall promptly pay to Electric & Gas the excess of the amounts therefore paid by Electric & Gas for such period over the energy and capacity charges, as thus recomputed. Generating Company shall have the sole and exclusive authority in its own absolute discretion to settle or otherwise dispose of any or all of its tax liabilities.

(I) Additional Generating Units: In the event that Generating Company should own or operate any power generating facilities other than the Station, the taxes, licenses and levies of Generating Company which shall be taken into account in determining the tax component pursuant to the provisions of Sections 3.04(A) and 3.04(B) shall be only such taxes, licenses and levies as are attributable to the ownership and operation of the Station. The taxes, licenses and levies of Generating Company attributable to such ownership and operation of the Station shall be the sum of:

(1) All taxes, licenses and levies of Generating Company which are specifically applicable or are allocable to the Station, including but not limited to ad valorem taxes, payroll and employment taxes with respect to employees working exclusively at the Station and levies on gross receipts and gross revenues derived from sales of power at said Station; plus

(2) Taxes on or measured by net income, net operating income, or excess profits, as determined under Section 3.04(B);

(3) A fair and equitable portion of all other taxes, licenses and levies to which Generating Company is or may be subject.

Section 3.05 Review of Practices and Procedures: Generating Company shall construct and operate the Station in a careful, prudent and efficient manner. Electric & Gas shall have the right from time to time to review and discuss with Generating Company its construction and operating

plans, practices and procedures.

R.1770

Section 3.06 Statements, Audits and Inspection: Generating Company shall furnish to Electric & Gas statements in reasonable detail as to all items entering into the determination of capacity charges and energy charges certified by an officer of Generating Company. Generating Company shall furnish to Electric & Gas annually a copy of an audit of its books and accounts for the preceding year made by an independent auditor. Electric & Gas shall have access at reasonable intervals to the books and records of Generating Company and shall have access to the Urquhart Station for the purpose of inspection. Upon the delivery or receipt of any such statements or audits, either party to this Agreement shall have four (4) months within which to check the same for errors, but if either party within such four (4) months period shall make no request for correction, such statements or audits shall be conclusive on both parties as to the facts therein set forth.

ARTICLE IV
REDUCTION IN KW CONTRACT DEMAND

Section 4.01 Reduction: Generating Company may reduce the KW Contract Demand of Electric & Gas as hereinafter set forth.

Section 4.02 Prior to Commercial Operation of Both Units: At any time before both units have been placed in commercial operation, Generating Company may reduce the KW Contract Demand of Electric & Gas by not in excess of 30,000 KW, upon written notice.

Section 4.03 After Commercial Operation of Both Units: On twelve (12) months written notice given after both units of the Urquhart Station have been placed in commercial operation, Generating Company may reduce the KW Contract Demand of Electric & Gas to the extent that the right of reduction under Section 4.02 has not been exercised.

ARTICLE V
BILLING AND PAYMENT

Section 5.01 Presentation and Payment: Generating Company shall render to Electric & Gas on or about the 10th day of each month a written bill for the amount due it by the terms of this Agreement for the preceding calendar month; and as adjustments in charges are determined from time to time hereunder, Generating Company shall promptly render a written bill or credit memorandum for the amount due it or Electric & Gas, respectively. All such bills or credit memoranda shall be due and payable by Electric & Gas or Generating Company, respectively, within ten days after rendition. All amounts payable to Generating Company by Electric & Gas shall be paid directly to the Generating Company at its main office, unless and until Electric & Gas shall receive from the Bank written notice specifying and demanding that payment of all amounts so payable be thereupon and thereafter paid to the Bank. Upon receipt of such notice Electric & Gas hereby agrees that all such payments shall thereupon be paid to the Bank until Electric & Gas shall have received from the Bank a further notice specifying and demanding that payment of any such amounts shall be made to the person therein specified. Such notices as are contemplated hereby may be given from time to time by the Bank, but in no event prior to the time that the contract is pledged as collateral security for the purposes stated in Section 7.08. Any payments made by Electric & Gas under direction of the Bank, as herein provided, shall constitu full satisfaction of the obligation of Electric & Gas with reference thereto as if such payments had been made directly to Generating Company.

Section 5.02 Remedies: If Electric & Gas shall fail to pay any bil within the time above allowed, Generating Company may, at its option, suspend the delivery of electric capacity and energy hereunder until all monies due

it have been paid, together with interest at the rate of six per cent (6%) per annum, said interest to run from the time such payment was due, to-wit: the 10th day after the rendition of such bill.

This right of suspension is in addition to all other rights at law or in equity which Generating Company may have in the circumstances, and the exercise thereof, or of any such rights in law or in equity, shall not be deemed to impair or abrogate this agreement in any way, and such right may be exercised whenever and as often as any such default in payment of bills shall occur, and any delay or omission on the part of Generating Company to exercise any right to it accruing in the case of default shall not be deemed a waiver of any rights hereunder or to which it might have recourse at law or in equity.

Section 5.03 Disputed Bill: If Electric & Gas shall, in good faith, dispute any bill so rendered, then within the period fixed herein for payment of the same, Electric & Gas shall pay Generating Company the amount charged in such bill, and without any deduction or set-off which it, said Electric & Gas, might claim, but shall set forth the basis of its contentions. If the parties thereafter cannot agree on the correctness of the bill in question, the dispute shall be submitted to arbitration as hereinafter provided. If as a result of such arbitration, Generating Company must refund any part of the monies thus paid by Electric & Gas, Generating Company shall forthwith make such payment, together with interest at the rate of six per cent (6%) per annum from the date of payment of such monies to it. Notwithstanding any of the foregoing, Electric & Gas may before or after its payment, dispute the correctness of any charges made on a bill, within the provisions of Section 3.06.

R.1743

ARTICLE VI
METERING

Section 6.01 Metering Equipment: There shall be provided by Generating Company at the Urquhart Station such metering equipment as may be necessary to measure accurately the electric capacity and energy to be furnished hereunder. Said metering equipment, including generator and station service meters, shall at all times be kept accurate within one per cent (1%) and Generating Company shall read such meters as often as required by Electric & Gas but not oftener than once every hour and shall thereupon transmit such readings to Electric & Gas. All measuring instruments shall be of a make and type to be agreed upon by a representative of each of the parties hereto duly appointed for such purpose. All measuring instruments pertaining to billing shall be sealed and shall be opened only in the presence of an authorized representative of each party hereto and all such instruments shall be tested by such representatives upon request of either party to the other, but at least once every six months. If, as a result of such test, any instrument shall be found to be inaccurate it shall be restored to a condition of accuracy satisfactory to such representatives or replaced by a new instrument or instruments satisfactory to such representatives. If the inaccuracy of any instrument shall exceed one per cent (1%) then the readings of such instrument previously taken, and all charges based thereon, shall be corrected on the basis of said test, but not for more than thirty (30) days prior to the date of test, nor prior to the date within such thirty (30) days upon which such meters have been proven or agreed to be accurate; provided that in the event of any disagreement between the parties hereto with respect to said measuring instrument or instruments, the subject of said disagreement shall be referred to arbitrators in the manner hereinafter provided.

Electric & Gas shall have the right to install, at its sole expense, duplicate instruments for checking, and space for the installation of such instruments shall be provided by Generating Company. Representatives of Electric & Gas shall at all times have access to the premises of Generating Company for the purpose of inspection or maintenance of such metering equipment of Electric & Gas. Generating Company shall have the right to test for accuracy such duplicate instruments at reasonable intervals.

If either party shall at any time discover that any instrument, either original or duplicate, registers inaccurately, or fails to register, then such party shall forthwith so notify the other party in writing. In the event of stoppage of an original instrument in respect to which no duplicate has been installed, or of both the original and duplicate instruments, the amount of electric capacity and energy furnished during the period of such stoppage shall be determined from any instrument readings or other data which may be available and applicable for the purpose, and such determination shall be used for billing hereunder.

Section 6.02 Records: Generating Company shall keep in duplicate a continuous log record of the operation of Urquhart Station on which shall be recorded at the end of every one (1) hour period the readings of all meters and instruments pertaining to the delivery of and billing for electric capacity and energy furnished by it to Electric & Gas hereunder. There shall also be recorded in such records a brief statement giving complete detailed facts in so far as possible as to any interruption or other unusual events affecting service. One set of said duplicates shall be mailed each day by Generating Company to Electric & Gas at its principal office in Columbia, South Carolina.

Section 6.03 Disagreement: Should Electric & Gas disagree in any instance with any interpretation, statement or conclusion of Generating Company as indicated in writing concerning the data sent to Electric & Gas, any question arising with respect thereto shall be taken up for adjustment between the parties within sixty (60) days from the mailing of such data by Generating Company, or such objection or disagreement shall be deemed to have been waived without prejudice to the right of Electric & Gas to dispute any similar data in the future.

ARTICLE VII
MISCELLANEOUS

Section 7.01 Responsibility and Indemnification: Generating Company shall not be responsible for electric capacity and energy after delivery by it to Electric & Gas at the delivery point. Each party hereto expressly agrees to indemnify and save harmless, and defend the other against all claims demands, costs or expense for loss, damage, or injury to persons or property in any manner directly or indirectly connected with or growing out of the generation, transmission or use of electric capacity and energy on its own side of the delivery point hereunder; provided, however, that each party hereto shall in all cases be responsible for damage or injury to its own employees and expressly agrees to indemnify and save harmless the other from all claims of such employees, except where the same shall be considered as part of the cost used in determining charges for capacity and energy under Article III.

Section 7.02 Operating Instructions: Generating Company agrees to comply with the reasonable operating instructions of Electric & Gas with regard to electric capacity and energy to be supplied under this agreement, and, at all times, to follow the reasonable instructions of Electric & Gas in operating the switches and other apparatus controlling the electric capacity

and energy to be supplied hereunder.

Section 7.03 Notice of Failure: In event of the failure of or injury to any apparatus of Generating Company, affecting its ability to supply service in accordance with the terms of this agreement, Generating Company shall give immediate notice by telegraph or telephone, to the operating headquarters of Electric & Gas in Columbia, South Carolina.

Section 7.04 Force Majeure: In case either party hereto should be delayed in or prevented from performing or carrying out the agreements, covenants and obligations made by and imposed upon said parties, or either of them, by this contract by reason of or through strike, stoppage in labor, failure of contractors, suppliers of materials, riot, fire, flood, ice, invasion, civil war, commotion, insurrection, military or usurped power, order of any Court or Judge granted in any bona fide adverse legal proceedings or action, order of any civil authority, or military either de facto or de jure, explosion, act of God, or the public enemies, or any cause reasonably beyond its control, and not attributable to its neglect, then, and in such case or cases, such period of delay or prevention shall not be reckoned or accounted as a part of the time within which such party was to perform and carry out the same, and the days, dates, times and periods (other than the expiration date of this Agreement) mentioned in this contract shall be extended for a period proportionate to such delay or prevention, nor shall such period relieve Electric & Gas of paying the capacity charge as above set forth in Section 3.02; provided, however, that the party or parties suffering such delay or prevention shall use all reasonable diligence to remove the cause or causes thereof, and either party claiming an extension of time hereunder shall immediately give to the other written notice of such claim.

Section 7.05 Regulation: Both parties recognize the fact that this agreement, together with all the terms thereof, may be or may become subject to approval, change, or modification by certain authorized agencies of the Federal Government and of the State of South Carolina, and no part of this agreement which is, or which shall later become, contrary to any valid rule, regulation, order, or decree of any such authorized agencies shall be binding upon the parties hereto during the period any provision hereof is contrary to any such valid rule, regulation, order, or decree.

Generating Company and Electric & Gas shall not during the term hereof make application to any legally constituted authority for an increase or decrease in the rate of charge for electric capacity and energy as set forth herein or for any change in the provisions of this agreement with reference to the delivery of electric capacity and energy hereunder.

Section 7.06 Term of Agreement: This contract shall become effective as of its date and shall continue in full force and effect for a period terminating on October 1, 1979.

Section 7.07 Assignability: This contract shall bind the parties hereto, their successors and assigns, but no assignment hereof shall in any event relieve Electric & Gas of any of its obligation hereunder.

Section 7.08 Hypothecation: The parties hereto agree that when, as, and if, the Generating Company shall execute and deliver an indenture to secure First Mortgage Bonds to be issued by it, this agreement may be pledged as collateral security for the payment of some or all of such bonds.

Section 7.09 Agreements Under the Contract: Notwithstanding any pledge of this contract as collateral security by Generating Company or the fact that the Bank is a party hereto, Electric & Gas and Generating Company are authorized to make any and all agreements contemplated by the several provisions of this contract or required in working out the operational or financial details thereof or construing or interpreting any provisions thereof without the consent of any pledgee or the Bank. No such agreement, however, shall, without the consent of such pledgee and of the Bank, be made with respect to the provisions of Sections 1.01, 1.02, 7.07, or 7.08 or of Article IV, or shall change the basic formulas for the computations for capacity or energy charges, load factor variance adjustments, or tax components set forth in Sections 3.02 through 3.04, inclusive, or affect the rights of the Bank under Section 5.01, and no such agreements with respect to any other provisions hereof shall be made which, in the aggregate, would have a material adverse effect on the security afforded to such pledgee.

ARTICLE VIII
ARBITRATION

Section 8.01 Arbitration: Any dispute hereunder arising over a question of fact shall be submitted to three arbitrators, to be selected as follows: One shall be selected by Generating Company, one by Electric & Gas,

and these two shall select a third, or in case they cannot agree on a third within ten (10) days after the two have been chosen, a third arbitrator shall, upon the written request of either of the parties hereto, be appointed by any person who is a Judge of the United States District Court of the District in which the Urquhart Station is situated, and the three arbitrators so selected hereunder shall hear and determine the matter in dispute and a decision by a majority of them shall be final and binding upon the parties hereto, provided, however, that if either party shall fail or neglect for a period of ten (10) days after receipt of written notice by the other to select an arbitrator upon its part, the arbitrator appointed by the party giving such notice shall select another arbitrator, and the two thus chosen shall select a third and the three thus chosen shall proceed to hear and determine the matter in dispute and a decision of the majority of the three shall be final and binding: and provided further, that each of the parties shall be given at least ten (10) days written notice prior to the hearing of any matter submitted to such Board of Arbitrators. The arbitrators' fees and the expense of the arbitration shall be borne and paid for by the party losing in the arbitration, but in the event of a divided award, the division of such fees and expenses shall be made as directed by the arbitrators. The parties to this agreement covenant with each other to abide by the decision of the arbitrators selected hereunder.

IN WITNESS WHEREOF, said Generating Company has caused these presents to be signed in its name by its President or Vice-President and attested by its Secretary or Assistant Secretary, and its corporate seal to be hereto affixed, thereunto duly authorized by its Board of Directors, the day and year first above written, and said Electric & Gas has likewise caused these presents to be signed in its name by its President or Vice-President, and attested

by its Secretary or Assistant Secretary, and its corporate seal to be hereto affixed, thereunto duly authorized by its Board of Directors, and the said Bank has likewise caused these presents to be signed in its name by its President or Vice-President, and attested by its Cashier or Assistant Cashier, and its corporate seal to be hereto affixed, all thereunto duly authorized and acting, the day and year first above written.

SOUTH CAROLINA GENERATING COMPANY

ATTEST:
(SEAL)

(Sgd.) R. E. Lide
Secretary

By (Sgd.) F. R. McAdden
President

SOUTH CAROLINA ELECTRIC & GAS COMPANY

ATTEST:
(SEAL)

(Sgd.) L. F. Pearce
Secretary

By (Sgd.) J. M. Costello
Vice-President

THE FIRST NATIONAL BANK OF SOUTH CAROLINA OF COLUMBIA

ATTEST:
(SEAL)

(Sgd.) W. W. Bruner
Cashier

By (Sgd.) Thomas J. Robertson
President

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APPENDIX TO PETITIONER'S BRIEF

IN THE

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 7391

SOUTH CAROLINA GENERATING COMPANY,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

No. 7393

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

ON PETITIONS FOR REVIEW OF AN ORDER
OF THE FEDERAL POWER COMMISSION

Petitioners' Appendix
Part I

THE STATE CONSTITUTIONAL PRINTING CO.

INDEX

Cases Nos. 7391 and 7393

PART I

Page

Petition of South Carolina Generating Company for Review 1

Petition of South Carolina Public Service Commission for Review 9

Federal Power Commission Order Initiating Proceeding 13

Answer of South Carolina Generating Company 19

Decision of Presiding Examiner of Federal Power Commission 29

Opinion No. 297 of Federal Power Commission Reversing Decision of Presiding Examiner 93

Petition of South Carolina Generating Company to Federal Power Commission for a Rehearing 121

Petition of South Carolina Public Service Commission to Federal Power Commission for a Rehearing..... 131

Federal Power Commission Order Denying Petitions for Rehearing 135

INDEX

PART II

Page

Statement 141

Direct Testimony of Harllee Branch, Jr. 142

Cross-Examination of Harllee Branch, Jr. 145

Redirect Examination of Harllee Branch, Jr. 149

Direct Testimony of Albert H. Gordon 150

Cross-Examination of Albert H. Gordon 157

Redirect Examination of Albert H. Gordon 159

Recross Examination of Albert H. Gordon 159

Direct Testimony of F. R. McMeekin 159

Direct Testimony of W. J. Ready 169

Additional Direct Testimony of W. J. Ready 176

Cross-Examination of W. J. Ready 184

Direct Testimony of J. M. Costello 191

Cross-Examination of J. M. Costello 194

Statement of Chairman of South Carolina Public Service Commission 199

Direct Testimony of Dale E. Goubleman 209

Direct Testimony of Kenneth L. Smith 215

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Petitioners' Appendix
Part I
Pages 1 to 139

PETITION FOR REVIEW

To the Honorable the United States Court of Appeals for the Fourth Circuit:

The South Carolina Generating Company (the Generating Company), created under the laws of South Carolina and engaged in business solely in that State, being aggrieved by the Order of the Federal Power Commission, issued October 24, 1956 (Opinion No. 297, Docket E-6585) and by the Commission's Order of December 20, 1956 denying petitions for rehearing, hereby petitions this Court to review these Orders of the Commission and in support of this petition would respectfully show:

I

JURISDICTION

The jurisdiction of this Court is invoked under §313 (b) of the Federal Power Act (16 U.S.C.A. §825 L). The order of the Commission was filed on October 24, 1956. A timely

petition for rehearing was filed by the Generating Company. This petition was denied by the Commission's Order of December 20, 1956.

II

THE HISTORY OF THE PROCEEDINGS BEFORE THE COMMISSION

The Federal Power Commission under date of October 27, 1954 adopted an Order directing the Generating Company to make a showing of facts necessary to permit the Commission to determine whether the Generating Company's rates and charges to Georgia Power Company (Georgia Power) under a contract dated November 9, 1951 were unduly discriminatory, unjust or unreasonable. The Georgia Public Service Commission and the South Carolina Public Service Commission were permitted to participate in the hearings.

The testimony was taken before a hearing Examiner. After all the testimony had been completed and the issues had been exhaustively briefed the Examiner filed his Decision on February 29, 1956 in which he found that the Generating Company's rates and charges to Georgia Power were not unduly discriminatory, unjust or unreasonable. The Examiner ordered, subject to review by the Commission, that the investigation be terminated and the proceeding dismissed.

The staff of the Federal Power Commission and the Georgia Public Service Commission filed exceptions to this Decision. Oral argument on these exceptions was had on May 10, 1956 before three of the members of the Commission, two of whom participated in the decision. The Commission under date of October 24, 1956 reversed the Examiner's initial decision, found the rates and charges unjust and unreasonably high, and ordered the Generating Company to file a new rate schedule which would (a) effect a reduction in charges for the year 1956 and annually thereafter totalling some $252,186.00 per year, (b) eliminate from the contract certain escalator provisions and (c) modify other clauses of the contract. The Commission did not find undue discrimination.

After the denial of the Petition for Rehearing on December 20, 1956, this Petition for Review followed.

III

THE CONTRACT IN ISSUE

The contract of November 9, 1951 provides that the Generating Company will sell and Georgia Power will buy over a 25 year period electric energy up to a maximum demand of 75,000 KW generated at Generating Company's "Urquhart Plant" located on the South Carolina side of the Savannah River and transmitted over 115 KV line to an interconnection with Georgia Power at the state line. The contract contemplates that Georgia Power is entitled to a maximum of one-half of the output of each of the first two 75,000 KW generating units installed at Urquhart. The billing to Georgia is under a two-part capacity and energy type rate. This means that a charge is made for the maximum energy that Georgia Power would be entitled to take at any one time (since the investment in facilities must be made and maintained in order to enable the utility to provide the capacity for meeting that demand whenever the customer wishes), and a different charge is made for the amount of energy actually taken in any period, since operating expenses must be paid in order to produce that energy. It is the capacity component which is at issue here. The contract contains provisions permitting the Generating Company to cancel or to reduce deliveries after stated notice periods.

This is the only contract of the Generating Company subject to the jurisdiction of the Federal Power Commission.

IV

THE PARTIES AND THEIR POSITIONS

The Generating Company was organized in 1951. It is a wholly owned subsidiary of South Carolina Electric and Gas Company (Electric and Gas), which is also a South Carolina corporation engaged in the generation, transmission and distribution of electric energy in South Carolina. All of the properties of both corporations (with the exception of a part of a hydro-plant on the Savannah River) are located and their principal place of business is in South Carolina and neither operates elsewhere. Both are subject

to the regulatory jurisdiction of the South Carolina Public Service Commission.

Georgia Power is an electrical utility operating entirely in the State of Georgia. It has no corporate or financial connection of any kind with the Generating Company or with its parent, Electric and Gas. It is subject to regulation by the Georgia Public Service Commission. It was not a party to the proceedings before the Federal Power Commission but, through the testimony of its President, it supported the validity of the contract and the reasonableness of the charges under it.

In the proceeding before the Commission the South Carolina Public Service Commission supported the position of the Generating Company.

The Georgia Public Service Commission took the position that the rates and charges in the contract were unduly discrimnatory, unjust and unreasonable. That position was also taken by those members of the staff of the Federal Power Commission who participated in the hearing. The Commission's order adopts the staff position that the rates and charges were unreasonably high to the extent of $252,186.00 annually.

V

THE MATERIAL FACTS

In November 1950 when the United States announced that it would construct a large hydrogen bomb plant near the Savannah River in that portion of South Carolina served by Electric and Gas, that company negotiated with the AEC and with duPont, who acted as agent of AEC for suppiying its electric requirements. The only way the needs of AEC could be met satisfactorily was by utilizing the entire resources of the system to finance a specially organized generating subsidiary, whose debt ratio would be higher than an independent company could possibly market and higher than was permitted to the parent itself under the restrictions of its existing mortgage. Since purchasers of securities of the parent would appraise the enterprise on a consolidated basis, the parent would be required, after financing the subsidiary, to raise increasing proportions of its new capital requirements through equity securities, at correspondingly

increased costs. But the public desirability of meeting the needs of AEC make it desirable to go ahead with the arrangement.

Georgia Power, learning of this arrangement and being in need of additional power itself, entered into negotiations in 1951 for service from the new Generating Company. After an arms' length trade, where each party had the benefit of expert advice on the cost of equivalent energy to Georgia Power through its own construction and from other sources, the contract herein in issue was made. Under it Georgia Power obtains 75,000 KW of energy at a charge of $600,000 less each year than it could have obtained it elsewhere. Its officers consider that it made a good trade in 1951 and that the contract is still a good contract for Georgia Power and for its customers.

The ability to finance the construction of the Urquhart plant by the Generating Company was only possible because of the credit of the parent company and of burdensome commitments by the parent. In addition to these obligations which it assumed, the parent was required by the high debt ratio of the Generating Company to finance its own expansion during the years when Urquhart was being built (1951-1954) with more expensive equity money. Seventy-two per cent (72%) of the parent's new money during these years came from common stock equity. Therefore, to determine the reasonableness of the rates and charges in the Georgia contract the Commission and the Court should look at its effect on the Electric and Gas system by which the service was provided, not merely to the cost of this energy, as separately computed, to the Generating Company, which was only the immediate instrumentality.

VI

POINTS TO BE RELIED UPON

The points urged in support of this Petition for Review are those included in the Petition for Rehearing filed with the Federal Power Commission. They may be thus summarized.

1. Where two unaffiliated electric utilities, bargaining at arms length and neither being under any legal obligation

to buy from or to sell to the other, reach an agreement for the sale and purchase of 75,000 KW of electrical energy over a twenty-five (25) year period, on terms and conditions of benefit to both, the resulting contract is not subject to modification by the Federal Power Commission in the absence of a showing that the rates and charges to the Purchaser are so high as to impair its financial ability to continue its public service or so high as to cast upon its customers an excessive burden. Since the undisputed testimony before the Commission shows that the effect of this contract is to save Georgia Power six hundred thousand ($600,000.00) dollars annually there can be no such showing.

2. Where two unaffiliated electric operating utilties serving adjacent territories enter into a mutually beneficial contract, fairly negotiated, providing for joint participation in building and operating additional generating facilities which results in substantial economies to each, the Federal Power Commission can not substantially alter the contract merely because the rates and charges may not fit into a "cost to serve" formula.

3. If the issue of reasonableness of the rates and charges to Georgia Power under this contract were to be tested by a "cost to serve" formula the Commission should have determined the realistic cost to the entire Electric and Gas system to serve this contract rather than the technical cost to its wholly owned subsidiary, the Generating Company. As shown above, this was only part of the whole. Since, by the Commission's own finding, the consolidated capitalization ratios must be taken into account to determine the real cost of the generation, by the same token the consolidated tax deductions must equally be taken into account, since they are merely a consequence of capitalization. When the Commission looked only at the subsidiary's taxes separately computed and ignored the consolidated taxes, which were the only realistic measure, its action was arbitrary and without warrant in law.

4. There is no substantial evidence justifying the decision of the Federal Power Commission that the rates and charges under the contract between the Generating Company and the Georgia Power Company were unjust or unreasonable.

5. Under the applicable provisions of the Federal Power Act, the Commission may not fix just and reasonable rates until it has first reached a determination, based on substantial evidence, that the contract rates are unreasonable and unjust.

6. Since the parties to the contract had agreed upon automatic adjustment in plant investment and expenses and such agreement does not violate any provision of law it was arbitrary and beyond the power of the Commission to strike these parts of the contract, the effect of which will unnecessarily burden the parties and the Commission with requests for rate order modification and, because of "regulatory lag", prejudice the Generating Company.

7. Where a hearing Examiner has taken the testimony, heard all the testimony and made his initial decision with detailed findings on the basis of the great preponderance of the evidence it is not sound administrative procedure for the Commission, when no Commissioner has heard any of the evidence and only two have heard oral arguments to summarily discard the entire initial decision and file its own opinion and order contrary to the great weight of the evidence. The action of the Commission here is arbitrary and beyond its power.

8. The action of the Commission is further arbitrary and void for all of the reasons stated in the petition for rehearing, a copy of which will be filed herein and is incorporated by this reference.

VII

PETITION FOR STAY

9. On November 7, 1956, Generating Company petitioned the Commission to Stay the effect of its order reducing the rates and charges involved pending final disposition of the matter by the Commission. Pursuant to this petition, the Commission issued its order on November 16, 1956, staying the effect of the newly prescribed rates for a period extending 60 days after final action by the Commission, provided the Generating Company filed with the Commission an agreement by the Generating Company to receive payments, subject to its obligation to refund, with interest, the excess

over and above the prescribed rates and to keep accurate accounts, in connection therewith, and to establish a reserve therefor. Generating Company accepted these conditions by its "Acceptance of Order Granting Stay" dated the 21st day of November, 1956.

10. Should the rates and charges prescribed by Respondent's Opinion No. 297 be made effective and this Honorable Court subsequently sustains the prayer of this "Petition for Review" thus necessitating retroactive billing and computations for which no procedure is presently provided, a great burden and unnecessary cost and expense will be cast on the Generating Company and on Georgia Power, all of which will be against the public interest, whereas if the rates presently in effect are maintained until such time as the matter is ultimately adjudicated there will be no such added burden, while the Court would preserve, as did the Commission, full power to carry out the decision of the Commission if it should be confirmed, without loss or injury to Georgia Power.

WHEREFORE, The Petitioner prays that this Court review the order of October 24, 1956 and the order of December 20, 1956 denying a rehearing and enter an order setting them aside in whole and enjoining their enforcement [see 16 U.S.C.A. §825 L.(b)]. In addition, Petitioner prays, pursuant to 16 U. S. C. A. §315 (c), that the Court enter an order staying the Commission's order of October 24, 1956, until thirty days after this Court shall have entered its final judgment herein.

T. JUSTIN MOORE,
Richmond, Virginia
ARTHUR M. WILLIAMS, JR.,
W. C. MCLAIN,

February, 1957

DAVID W. ROBINSON,
Columbia, South Carolina
Attorneys for the Petitioner,
South Carolina Generating Company

IN THE

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 7393

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

PETITION FOR REVIEW

To the Honorable the United States Court of Appeals for the Fourth Circuit:

Now comes the South Carolina Public Service Commission, an agency of the State of South Carolina, and petitions this Court to review the Order of the Federal Power Commission issued October 24, 1956 (Opinion No. 297, Docket E-6585) and its Order of December 20, 1956 denying petitions for rehearing since the South Carolina Public Service Commission is aggrieved by these orders within the meaning of Section 313 (b) of the Federal Power Act.

I

The Federal Power Commission by its Order of October 24, 1956 reduced the rates and charges made by the South Carolina Generating Company (Generating Company) to

the Georgia Power Company (Georgia Power) under the contract between these parties dated November 9, 1951 by the sum of $252,186 annually and struck from the contract escalator clauses which permitted the modification of charges without the necessity of regulatory action.

The Generating Company and its parent company, the South Carolina Electric and Gas Company, are South Carolina corporations and operate only in that state. As electric, gas and transportation utilities they are subject to the regulation of the South Carolina Public Service Commission. The jurisdiction and regulatory authority of the Federal Power Commission extend only to this one contract.

The effect of the action of the Federal Power Commission in altering the contract between the Generating Company and Georgia Power is to invade the regulatory jurisdiction of the South Carolina Public Service Commission and to impair its ability to regulate this electric utility whose business is essentially intrastate in violation of the spirit of the Constitution of the United States and of the Federal Power Act.

II

The contract between the Generating Company and Georgia Power was a fairly negotiated agreement under which two independent operating electric utilities serving contiguous territory, neither with any public service obligation to the other, entered into a contract for the joint use of generation facilities which resulted in substantial economies to both and benefited the customers of each. It should not be altered by the Federal Power Commission merely because it does not fit a "cost to serve" formula.

III

Since the operations of the South Carolina Electric and Gas Company are wholly within the State of South Carolina the question of the creation of this subsidiary (Generating Company) in order to finance and build an electric generating plant on terms which permitted serving the needs of AEC was submitted to the South Carolina Public Service Commission. Later, Generating Company's financing and its con-

tract with Georgia Power were examined and carefully studied to make sure that they served the public interest. Only when this Commission was satisfied that they did were the plans approved. The rates and charges included in the contract between Generating Company and Georgia Power were an essential part of the plan. The reduction of those charges as contemplated in the Order of October 24, 1956 and the revision of the escalator clauses will have a harmful effect upon the public interest, particularly the customers of the South Carolina Electric and Gas system who will have to bear the burden of this reduction to Georgia Power. The Federal Power Act was intended to supplement, not supersede state regulatory jurisdiction. The action of the Power Commission here disregards the jurisdiction of your Petitioner and should be set aside by this Court.

IV

The action of the Federal Power Commission here will have the effect of discouraging neighboring utilities from cooperating in the building and use of electric generating plants and the free flow of electric energy over interconnected transmission lines and therefore will prejudice the public interest which the Federal Power Act was intended to benefit.

V

The Order of October 24, 1956 casts doubt upon the power of the Generating Company to exercise its contract right to terminate this sale upon the notice contemplated in the agreement. This provision in the contract was a major factor in securing the approval of this Commission to the sale of this large block of power for use outside the state. The protection of the electric rate payers in South Carolina requires that this power be used in South Carolina when economic conditions require. The decision as to when that time will arrive is for the Generating Company under the terms of the contract, subject to the general regulatory supervision of the South Carolina Public Service Commission and not for decision by the Federal Power Commission as indicated in Opinion No. 297.

VI

The record shows that the sale to Georgia Power was, in reality, made by the South Carolina Electric and Gas Company and in determining whether the charges are unreasonably high it was the duty of the Federal Power Commission to consider the impact of the contract on the entire system, which that Commission refused to do on the important matter of Federal income taxes.

VII

Clauses in long term power contracts which escalate charges with rising and falling prices permit prompt and necessary adjustments without the burdens and delays of regulatory proceedings. Such clauses are legal and appropriate subjects for consideration by buyer and seller. It was arbitrary for the Federal Power Commission to strike such clauses from the contract in issue here.

WHEREFORE, the Petitioner prays that the Court review the Order of October 24, 1956 and the Order of December 20, 1956 and enter its order setting aside and enjoining the enforcement of these Commission orders.

Respectfully submitted,

T. C. CALLISON,
Attorney General
for the State of South Carolina

IRVINE F. BELSER,
Assistant Attorney General
for the State of South Carolina and
General Counsel for the South Carolina Public Service Commission
Attorneys for Petitioner.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Claude L. Draper, Nelson Lee Smith, Seaborn L. Digby and Frederick Stueck.

In the Matter of
South Carolina Generating Company } Docket No. E-6585

ORDER INITIATING PROCEEDING

South Carolina Generating Company (Generating Company), incorporated under the laws of the State of South Carolina, with its principal place of business at Columbia, South Carolina, by letter dated July 24, 1953, tendered for filing as its FPC Rate Schedule an agreement dated November 9, 1951,[1] providing for the supply of a portion of the energy requirements of the Georgia Power Company (Georgia Company), at up to a maximum demand of 75,000 kw. Generating Company, a wholly-owned subsidiary of South Carolina Electric and Gas Company (South Carolina Company) included as a part of that filing a copy of another contract dated November 9, 1951,[2] pursuant to which Generating Company agreed to supply a portion of the energy requirements of its parent at up to a maximum demand of 75,000 kw.

In both instances the energy supplied is to be generated at Generating Company's Urquhart steam electric generating station located near Beech Island, South Carolina, with delivery to South Carolina Company at 115 kv at Generating Company's Urquhart substation and delivery to Georgia Company a short distance away at the point of interconnection of the 115-kv transmission facilities of the Generating Company and those of Georgia Company at the Georgia-South Carolina State Line. From the aforementioned filing and other information submitted to the Commission by the three companies it appears that all of the energy delivered to Georgia Company is thereafter resold and consumed at points outside of the State of South Carolina; and

[1] Accepted for filing effective October 1, 1953, and designated as Generating Company's Rate Schedule FPC No. 1.

[2] Identified as Fxhibit A to Generating Company's Rate Schedule FPC No. 1.

it further appears that all of that delivered to South Carolina Company is thereafter resold and consumed at points within the State of South Carolina.

Under the foregoing agreements which are to terminate in 1979 each purchaser is entitled to a maximum of one-half of the output of each of two 75,000-kw generating units presently installed at the Urquhart station;[3] subject, however, after both units are in service, to the right of Generating Company on twelve months' notice to reduce Georgia Company's entitlement by 25,000-kw and South Carolina Company's by 30,000-kw. In the event of an outage of one of these units Georgia Company would be entitled to one-half of the output of the remaining unit and to no service upon the outage of both. After the plant is in service, Generating Company may cancel its obligation to Georgia Company upon thirty months' notice.

Billing under both agreements is in accordance with a two-part capacity and energy type rate. The basic capacity charge to each amounts to $15.30 per kw per year, subject to adjustment to reflect any difference in amounts of estimated investment and fixed operating costs of the Urquhart Station as set forth in the agreements from those actually experienced.[4] But in the case of the sale to the Georgia Company this basic charge is increased by the addition of a component of $7.20 per kw, or $540,000 annually. That additional amount is said to have been agreed to as representing 50% of the savings accruing to Georgia Company by reason of its purchase of energy from Generating Company in lieu of constructing an equivalent amount of capacity on its own system.

The energy charge to both customers is designed to cover certain stated operating expenses connected with the Urquhart station estimated to amount to 3.49 mills per kwh.

According to the agreements the basic capacity charge, which as currently adjusted amounts to $18 per kw per year, covers interest on and amortization of the principal of 90% of Generating Company's investment (including working

[3] The first unit was placed in service in November 1953, and the second unit in January 1954.

[4] As currently adjusted the basic capacity charge amounts to $18.00 per kw per year.

capital) in the Urquhart station over a period of 25 years;[5] return on the remaining 10% equity at 8%; and an amount for insurance, Federal, State and local taxes, administrative and general expense and operating supervision and labor costs. The energy charge, currently estimated at 3.49 mills per kwh, covers fuel and maintenance expenditures incurred in the operation of the Urquhart station together with any generation taxes imposed upon the Generating Company.

Upon being informed that the staff was undertaking an analysis of its rates, Generating Company several times requested and held informal conferences with members of the Commission's staff, in the course of which its representatives submitted two computations of the company's cost of serving Georgia Company during the 12-month period ending October 31, 1953. Inasmuch as no service was rendered to Georgia Company prior to November 1953, the studies extensively employed estimates. One of these based the determination of the cost of serving Georgia Company upon the integrated system costs of Generating Company and South Carolina Company but without any allowance for the difference between the limited service rendered from the two units of the Urquhart plant and firm power service from South Carolina Company's integrated system. The other reflects Generating Company's service costs based on a hypothetical "orthodox capitalization plan"[6] for the Generating Company instead of the actual 90% debt and 25-year amortization plan.

In the submission of both studies Generating Company's representatives alleged without supporting data that the $540,000 extra annual charge to the Georgia Company is justified, chiefly because of (1) additional obligations and risks voluntarily incurred by South Carolina Company in underwriting the entire investment of Generating Company; (2) anticipated higher financing costs South Carolina Com-

[5] Generating Company's plant investment associated with the aforementioned two generating units approximates $27,000,000 which was financed per one million dollars of capitalization as follows:

$750,000 — 25 year 3⅞% bonds
$150,000 — 10 year 4% debenture notes
$100,000 — equity at 8%

[6] The capitalization assumed by Generating Company contemplated a debt ratio of 50% at a rate of interest of 3½%.

pany will incur in the future due to a reduction of the equity ratio shown on its consolidated balance sheet as a result of Generating Company's high debt ratio; (3) services rendered by South Carolina Company in the planning, financing and construction of the Urquhart station for which no charges were made, and selection of the location of the plant mainly for reasons favoring the Georgia Company; (4) the failure of the Public Service Commissions of Georgia and South Carolina and the Georgia Company to voice any objections to the agreements at the time of their execution; and (5) the possibility that the cost of any additional capacity installed in the Urquhart station in the future to serve South Carolina Company may exceed that of presently installed capacity and result in higher charges to ultimate consumers in South Carolina.

On June 18, 1954, the Public Service Commission of Georgia filed a letter with this Commission stating in part as follows:

> It is the view of this Commission that there appears to be undue discrimination in the Generating Company's rates in favor of its parent and it is also our view that it would be in the public interest to make further inquiry in the matter of discrimination to determine whether or not some revision in the rates should be made. We would like to state further that in the event there should result any downward modification in the demand rate charged Georgia Power Company, it will be our purpose to see that such reduction in power cost is passed on to the consumers of Georgia Power Company.

In view of the foregoing the Commission finds it necessary and appropriate in carrying out the provisions of the Federal Power Act to order as hereinafter provided.

The commission *orders*:

(A) Generating Company shall make a showing of the facts necessary to enable the Commission to find and determine whether:

(1) Generating Company, by virtue of its ownership and operation of the facilities to effectuate the above-described sale of electric energy to Geor-

gia Company owns and operates facilities subject to the jurisdiction of the Commission.

(2) The sale to Georgia Company is a sale at wholesale in interstate commerce, subject to the provisions of Sections 205 and 206 of the Federal Power Act and the rules and regulations thereunder.

(3) The rates and charges for the service to Georgia Company as set forth in Generating Company's Rate Schedule FPC No. 1 are unduly discriminatory within the meaning of Section 205 of the Federal Power Act and unlawful; and whether the Commission should order that Generating Company file a new rate for that service eliminating all substantial differences between the charges and related provisions of the schedule of rates to Georgia Company and those of the rate schedule in effect for the service to Generating Company's parent-customer South Carolina Company.

(4) The charges to Georgia Company provided for by such rate schedule are unjust and unreasonable; and if so what rate the Commission should order Generating Company to file.

(B) Without in any way precluding or limiting Generating Company from making any showing it wishes to make of facts relevant and material to the questions posed by this order, and without prejudice to any position Generating Company may wish to take as to the significance or lack of significance of the facts hereinafter specified, and also without this Commission at this time deciding that question but reserving full freedom to decide all the questions on the full record in the light of all arguments that may be adduced before it, Generating Company shall show its cost of rendering the service to Georgia Company, calculated in accordance with applicable Commission precedents and using, among other things, (i) a prudent investment rate base with the deduction for accrued depreciation computed on the basis of

straight line depreciation; (ii) a fair rate of return; (iii) taxes actually to be paid over the life of the contract. This showing shall be made for the first two units in commercial operation; (1) for the calendar year 1954 using actual experience insofar as data are available for the period the two units shall have been in commercial operation and estimates based upon actual experience for the remainder of that year; (2) for every fifth year thereafter for 25 years, by use of the same figures with adjustments to reflect changes in net investment, return, and federal and state income taxes, and other changes which are known and measurable with reasonable accuracy.

(C) Subject to the same conditions and reservations as set forth in (B) above, Generating Company shall show its revenues from Georgia Power for the same years based upon the same operations under its Rate Schedule FPC 1.

(D) The foregoing showing shall be submitted in writing under oath within 60 days of the issuance of this order, with sufficient copies to provide 5 for the Commission, 2 for each of the State Commissions of Georgia and South Carolina, and 1 each for any others who may have been admitted as interveners.

(E) A public hearing on the foregoing issues be held at a time and place to be fixed hereafter.

(F) Interested State commissions may participate in this proceeding as provided in Sections 1.8 and 1.37 (f) [18 CFR 1.8 and 1.37 (f)] of the Commission's General Rules and Regulations.

By the Commission. Commissioner Digby dissenting.

/s/ Leon M. Fuquay
Leon M. Fuquay,
Secretary.

Adopted: October 27, 1954
Issued: October 29, 1954

In the Matter of
South Carolina Generating Company } Docket No. E-6585

ANSWER OF THE SOUTH CAROLINA GENERATING COMPANY

The South Carolina Generating Company ("Generating Company") by way of answer to the Order of the Commission of October 27, 1954, respectfully shows to the Commission:

1. The South Carolina Generating Company is a South Carolina corporation, organized in 1951, under and pursuant to the laws of the State of South Carolina in such cases made and provided; all of its property is located in the State of South Carolina, and it is a wholly owned subsidiary of the South Carolina Electric & Gas Company, which company is also a South Carolina corporation organized and existing under and pursuant to the laws of that State.

2. The South Carolina Electric & Gas Company ("Electric & Gas") is a South Carolina corporation engaged, *inter alia,* in the business of generating transmitting, distributing and selling electrical energy within the State of South Carolina. Prior to 1946, Electric & Gas was a subsidiary of General Public Utility Company, a registered Holding Company. In 1946 Electric & Gas became an independent, operating electric utility, wholly free from holding company supervision or control, through a stock divestment plan. Its stock is widely held by approximately 30,000 stockholders. Thereafter, in 1948, it acquired the properties of the South Carolina Power Company which operated in a contiguous service area, whose divestment by its holding company, Commonwealth and Southern, had been ordered by the Securities and Exchange Commission. This latter company was merged into Electric & Gas in 1950. Electric & Gas now operates in twenty-six (26) counties in central and southeastern South Carolina, and is an electrical utility under the laws of South Carolina, subject to the jurdisdiction of the Public Service Commission of South Carolina as to its rates, services, issuance of securities, and other matters.

3. In common with other electrical utilities, Electric & Gas in the post-war period experienced a phenomenal growth, requiring the addition of substantial generating capacity. By the summer of 1950 it had substantial steam electric gen-

erating facilities in the northern and southern portions of its system and began planning its next steam generating facilities in the west-central area, contemplating the building of a plant on the Edisto River near Branchville, South Carolina. When there was public announcement in November, 1950, of the Atomic Energy Commission to locate its large hydrogen plant in territory served by Electric & Gas, negotiations were begun by Electric & Gas with E. I. duPont de Nemours and Company ("duPont") as agent for the AEC, to meet the power requirements of AEC at its Savannah River plant, which at that time were estimated as divers figures running as high as 250,000 kw. In the early stages of these negotiations it became evident that duPont would require rates lower than Electric & Gas could furnish if it financed its generating plant on the usual debt ratio and that in order to serve AEC it would be necessary to finance with a higher debt ratio in line with the capital structure of Electric Energy, Inc., which served AEC's needs at Paducah, Kentucky.

The Georgia Power Company ("Georgia") was at that time in need of additional generating capacity in the Augusta, Georgia, area, just across Savannah River from the AEC site, and was planning to install near Augusta a steam unit with a capacity of approximately 66,000 kw. Georgia learned of Electric & Gas's plans and approached it as to the possibility of additional units being built at its contemplated station, to be located on the Savannah River rather than on the Edisto River, and a sale of a portion of the capacity thereof, together with the energy therefrom, to Georgia in lieu of each company's building separate plants.

4. These negotiations between Electric & Gas and du Pont, and between Electric & Gas and Georgia [1] resulted in

[1] The salient factors to be included in the Georgia agreement were covered in a letter dated June 26, 1951, to Georgia which was tentatively accepted by them on June 29, 1951, subject generally to assurance as to firm commitments for construction and feasibility of financing. The formal contract executed November 9, 1951, is on file with the Commission as Exhibit "A" to South Carolina Generating Company's Rate Schedule, FPC No. 2.

By June 15, 1951, negotiations with du Pont had proceeded sufficiently for Electric & Gas to write them a letter on that date outlining the principal factors in a proposed agreement, although at that time the proposal contemplated 63,000 kw contract demand by du Pont. This letter, with modifications including the reduction of contract demand to 30,000 kw, formed the basis for the du Pont-AEC "Letter of Intent" dated January 11, 1952. The du Pont contract was finally executed on March 1, 1954. The first draft of the contract with Georgia was dated July 18, 1951, and the contract was executed November 9, 1951.

the incorporation of the South Carolina Generating Company, the construction by it of Plant Urquhart with two 75,000 kw units, the financing of the construction costs by the issuance of debt securities for 90% of the costs, and the furnishing by Electric & Gas of the equity capital of 10%.

5. South Carolina Generating Company is engaged solely in the business of generating electrical energy in the State of South Carolina; all of its property is located within that State. It is an electrical utility subject to the jurisdiction of the Public Service Commission of South Carolina as to its rates, services, issuance of securities, and other matters. Its entire output of energy is sold under three contracts, one with Georgia, the second with du Pont, both as aforementioned, and the third with Electric & Gas, previously filed with the Commission as an exhibit.

6. In response to paragraph (a)-(1) of the Commission's order, this Respondent is the owner of a short transmission line between the Urquhart generating plant on the Savannah River and the Georgia-South Carolina state line, over which electrical energy required by Georgia contract is delivered to Georgia as is more fully hereinafter set forth.

7. In response to paragraph (A)-(2) of the order, this Respondent shows that its sale of electric energy to Georgia is a sale at wholesale, delivery being taken at the Georgia State line, presumably for use in that State, said electric energy having been generated in South Carolina, and that this is the only sale at wholesale made by Generating Company of energy not consumed within the territorial limits of the State of South Carolina.

8. In response to paragraph (A)-(3) of the order, this Respondent denies that the rates and charges for its services to Georgia are unduly discriminatory within the meaning of Section 205 of the Federal Power Act, denies that these rates and charges are unlawful, and avers that any differential between the rates and charges to Georgia and those to Electric & Gas are based upon legitimate differences in service, increased cost of financing Electric & Gas due to the high debt ratio of Generating Company, and because of the financial assistance rendered to Generating Company by Electric & Gas in setting up its capital structure.

9. In support of its above allegations that subject contract presents a rate that is neither unreasonable nor unduly discriminatory, Respondent respectfully directs the attention of the Commission to a fundamental consideration inherent in any review by a regulatory body of contracts of the nature involved in the case at bar:

Serving the public interest in the broad sense is the prime objective. The application of a theoretical cost formula, to the extent of disregarding other factors, is not the only test of public interest, and the review of estimated costs reflected on statements filed herewith should be made with due regard to the inconclusiveness of such statements viewed without adequate allowance for surrounding facts and circumstances. Projections indicate that billing under the present terms of the contract will each year be less than "costs" on a 6% return basis until 1962, and that subsequent annual billing excesses over "cost" will not absorb the accumulated deficit under 6% until 1970. A study of the attached statements would reveal that for 1954 the rate of return per year under the contract will be 4.64%; for 1955 it will be 4.97%; 1956 will be 5.11%; 1957, 5.25%; 1958, 5.39%; not until 1959 does it reach even 5½%: in that year it is 5.54%.

Any "Cost to Serve" statement involves some judgment factors but Statement 1, filed herewith, rests almost entirely upon estimates projected twenty-five (25) years into the future, most of which can and probably will change, and some of which involving a consideration of such factors as obsolescence, tax rates, money rates and even, perchance, disaster, can radically change overnight without having any or a proportionate effect upon the billing under the power contract. This further disqualifies the cost to serve formula as an exclusive measure of the reasonableness of rates. It not only ignores the value of the service which may be jeopardized by rate changes to conform to a "cost" measure, but it is also an imperfect measure of "cost" and the farther the projection, the less perfect is the focus.

Attention is directed to the use of a 6% return on this statement. The use of high debt ratio by Respondent inevitably required a high equity ratio on the parent company

for consolidated leverage. This displaced equity capital on the parent with its higher annual return and tax requirements are present in the system which fathered the Generating Company but are not to be found on the books of Respondent. Also, the normal risks of the utility business are exceeded in the investment here involved which should be reflected in the return of Respondent and its parent as guarantor. The 6% rate may well be an inadequate measure of these system factors. The fact that such rates might, at some future date, yield a greater than a fair return is certainly an inadequate motive for disturbing those rates now during a period when they yield no greater than a fair return, and present the cheapest means by which the purchaser, Georgia, can secure the capacity and energy.

Surely, the *value* of the service to Georgia is a pertinent factor which cannot properly be ignored in contemplating any Commission step which might conceivably deprive Georgia of the benefits it now receives from the use of capacity and energy of the Urquhart Station. The decision by Generating Company to permit the contract to run for its full term or to terminate it at an earlier date will necessarily rest on the economics of the contract. From present indications, continued inflationary increases in cost will in all probability necessitate Electric & Gas exercising their contractual right of recapture of the full capacity now under contract with Georgia at an early date, which in all probability would be before we would have recovered from Georgia the full costs during such period on a fair value basis. Any development which reduces the economic value of the contract will tend to speed the day of recapture. This will necessarily require Georgia to replace this capacity and energy—and such replacement will necessarily cost substantially more than the capacity and energy it will thus lose. Surely unreasoning adherence to a theoretical formula should not be allowed to blind justice to realities that will benefit no one: neither the seller nor the purchaser, nor their respective ultimate consumers.

Even at the time of the negotiations in 1951—and it should be borne in mind that construction costs have risen since that

time—had Georgia built the 66,000 KW unit it planned, the resulting KWH cost of generation at a 90% load factor was estimated to amount to .965c per KWH. The joint study also disclosed that by participating with Electric & Gas for a plant with two units under one roof and financing on a high debt ratio basis, that the cost of such a project by Electric & Gas, on the same load factor, would result in a cost of .672c per KWH.

The resulting contract with Georgia was predicated on dividing the benefits so derived approximately one-half to each company.

Starting in 1955, the first full normal year of operation, the KWH cost of power will amount to 0.709c per KWH, and the cost per KWH substantially declines in the remaining years of the contract, which substantially supports our contention that Georgia's cost is less under this plan than if they had constructed a different type of plant; it also substantilly supports our estimates.

Distributing the benefits resulting from such a joint venture between Georgia and Electric & Gas in providing additional generating facilities required by both companies, has substantially cut the cost of producing power, and the advantages and benefits resulting from this joint venture have benefited not only the customers of Electric & Gas but also those of Georgia.

10. The above mentioned advantages accruing to Georgia cannot be found merely in the dollars appearing on a statement delineating the cost of service. Rate payers in the State of Georgia, served by Georgia, enjoy advantages far above those which would be, or would have been, experienced by them had Georgia constructed a generating station in the Augusta area. These may be briefly summarized in three categories, *id est*: (a) financial, (b) operating, and (c) technical.

(a) The financial advantages are implicit in the special type of financing employed by Respondent as compared with the normal type of financing which would be necessary for a Georgia Company plant. The statement of cost to serve discloses that in early years and for quite some time payments

required for the finance component and related taxes are substantially below a 6% return on the net investment. Furthermore, Georgia, at a time when it was faced with demands for substantial physical additions throughout its system, was relieved of the necessity of raising funds to provide for the construction of an Augusta station. A comparison of the sales and use tax statutes of the States of South Carolina and Georgia discloses exemptions in the South Carolina statute for the cost of machinery to be used in the production of electric energy with no such exemption in the Georgia statute, resulting in higher plant costs in Georgia for the construction of like facilities, and so a greater amount of financing would have been required.

(b) (1) Operating cost advantages also are apparent from a comparison of these statutes, the South Carolina sales tax statute providing for the exemption of the cost of fuel used in electric generation with no comparable exemption in Georgia. Other operating costs advantages in the Urquhart Station in comparison with a single unit station to be constructed by Georgia arise from economies in operating personnel costs spread over 150,000 KW capacity which would be relatively higher in a plant of lesser capacity.

(2) If Georgia had constructed a one unit station at Augusta, Georgia as they had proposed prior to contracting with the Generating Company, they would have suffered a 100% loss in capacity, with its attending voltage troubles, in event of outage of this unit, whereas, under this contract with Generating Company, they would have only a 50% loss in event of outage of one unit since, under their contract, they are entitled to 50% of all available capacity from the two units. Investment costs per KW also average less than in a station of greater capacity.

(3) Under their station ownership plan, it would have been necessary for Georgia to maintain minimum load requirements during certain off-peak hours when it would not have been economical for them to do so, whereas, under Generating Company contract, they are allowed to reduce their take below minimum load requirements on steam unit provided other loads on steam unit are sufficient to make up

this deficit. This factor has proven a considerable advantage to Georgia.

(4) Under the Georgia ownership plan, the unit maintenance cost would probably have been higher than the maintenance cost which Georgia bears under its purchase contract with Generating Company inasmuch as the station load factor of Generating Company is higher than the load factor of the Georgia load and since the maintenance is allocated on the basis of usage, Georgia benefits by this operation.

(c) Technical advantages which also produce dollar savings to Georgia include the advanced design of the Urquhart Station with an estimated 10% improvement in fuel economy over the design contemplated by Georgia for its station.

11. It should also be borne in mind in the public interest that the retail rates of Georgia generally compare favorably with those of Electric & Gas due to accidents of geography such as proximity to fuel sources and metropolitan concentrations. A reduction of rates under the contract here being considered would tend to increase this differential, especially in view of the fact that a given amount of decrease in cost to Georgia serving in excess of 500,000 electric customers would have less favorable impact per customer than the adverse impact per customer for the 160,000 customers served by Electric & Gas.

There is no basis in the relative sizes of companies involved for any inference of bargaining advantages to Electric & Gas, or that either was indifferent to the best interest of its customers in promulgating the subject contract; therefore regulation would be ill-advised to jeopardize the demonstrable values presently enjoyed by Georgia in order to achieve an exact conformity to a rate making formula, which at best is only a rough guide to desirable results, Georgia is, insofar as Respondent can ascertain, still satisfied with the agreement.

12. Since there is only one sale by Respondent over which the Commission could conceivably have jurisdiction, all other sales being subject, without argument, only to the regulation

of the South Carolina Public Service Commission, the Commission cannot consider the question of undue discrimination against Georgia by Respondent's sales to Electric & Gas, which question has been raised at least by inference.

Even if the Commission could consider the question, there is clearly no discrimination in such premises, as Electric & Gas has assumed certain burdens in its relation with Generating Company, in order to effectuate and enjoy the benefits from the construction of Generating Company's steam electric generating station at such an enormous savings—benefits shared in by Georgia and its customers—the cost of which burdens reduces the monetary differential existing between the price paid by it and the price paid by Georgia.

Briefly, some of these are:

(a) The impact on the capital structure of Electric & Gas of the financing involved;

(b) The guarantees by Electric & Gas of completion of construction of the plant and of earnings therefrom;

(c) The guarantee of Electric & Gas to take over the obligations of the plant in case of disaster, in which cases Georgia is relieved of further obligation under the agreement here under discussion. The proximity of this plant to the AEC project does not make this disaster hazard unrealistic.

(d) The guarantee of Electric & Gas of back-up in certain instances of Generating Company sales.

(e) Under Generating Company's contract with Georgia, it is Generating Company's obligation to control and regulate the flow of power over Georgia's interconnection. In order to accomplish this, it must either isolate a unit on Georgia, or Electric & Gas must isolate a portion of its system from its other interconnections. Therefore, when one of Generating Company's units is out of service, Electric & Gas must either lose its share of the capacity from Generating Company or split its system at other points. Under such split conditions, it would not be able to avail itself of all of its capacity on its other stations. To overcome this condition, it will be necessary for Electric & Gas to install phase shifting equipment at an estimated cost of $600,000. This phase shifting equipment would consume approximately 375 KW of power. There-

fore, the total annual investment, maintenance, and operating cost would exceed $100,000.

(f) Service to Electric & Gas is actually inferior to that rendered Georgia under its contract, due to the subordination to the AEC of the parent company rights to capacity in the event of an outage of one unit. The commitment to provide capacity for AEC was recognized before the Georgia contract was negotiated.

13. Subject to the reservation above set forth denying the Commission's right to consider the question of discrimination, it is further respectfully urged that since the rate charged to Georgia does not exceed the true cost of rendering that service, and since that rate is just and reasonable and since ultimate consumers of Georgia are not placed at a competitive disadvantage with consumers of Electric & Gas, any differential in rates and charges does not make the rate to Georgia discriminatory within the meaning of the Federal Power Act.

14. Answering paragraphs (B) and (C) this Respondent submits the attached statements 1 and 2 with supporting details. Respondent further respectfully states that these statements, together with this answer, are interdependent, and must be read and considered together as a whole.

15. Respondent, South Carolina Generating Company, avers that the arrangements under which it came into being, its financing, its construction of the Urquhart plant, and its marketing of the power therefrom, have resulted in substantial benefits to Georgia and to the Atomic Energy Commission, its only two independent customers, in that by reason of these arrangements it has been able to furnish substantial amounts of power to each of these customers at rates and charges less than this power could be obtained from any other source; that the rates and charges here involved are just, reasonable and non-discriminatory within the meaning of the Federal Power Act; and that these arrangements, as evidenced by this answer and the contracts referred to herein, if not disturbed by this Commission, will result in substantial benefits to all ultimate consumers concerned over the period of the contracts.

WHEREFORE, having fully answered, this Respondent asks that the Commission declare that the rates and charges under its contract with the Georgia Power Company are just and reasonable and not unduly discriminatory.

Respectfully submitted,
South Carolina Generating Company
(Sgd.) J. M. Costello
By .....
J. M. Costello, Vice President

Columbia, S. C.
January 15, 1955

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DECISION

EMORY J. WOODALL, *Presiding Examiner*

In the Matter of
South Carolina Generating Company
Docket No. E-6585

UPON AN INVESTIGATION OF RATES AND CHARGES

APPEARANCES

For South Carolina Generating Company

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For South Carolina Public Service Commission

CLYDE F. BOLAND, *Chairman,* South Carolina Public Service Commission

ROLAND BOYLE, *Esquire,* Columbia, South Carolina

For Georgia Public Service Commission

WALTER R. MCDONALD, *Commissioner* and N. KNOWLES DAVIS, *Chief Engineer,* Georgia Public Service Commission

For Federal Power Commission

HOWARD E. WAHRENBROCK, *Assistant General Counsel,* and THEODORE FRENCH, *Esquire,* Washington, D. C.

WOODALL, Presiding Examiner: The order initiating this proceeding issued October 29, 1954, relates to the arrangement whereby South Carolina Electric and Gas Company (S. C. Company) created a wholly-owned subsidiary company, South Carolina Generating Company (Generating Company) as the instrumentality to build, finance and operate the Urquhart steam electric generating plant, which besides making other deliveries provides a supply of electric energy up to 75,000 kw as part of the energy requirements of the Georgia Power Company (Georgia Company). The agreement for such sale by the Generating Company dated November 9, 1951, was filed with this Commission, was accepted for filing effective October 1, 1953, and was designated as South Carolina Generating Company's Rate Schedule FPC No. 1. It was incorporated in evidence by reference as Item A in this record.

RATE INVESTIGATION ORDER

The Order Initiating Proceeding is attached hereto as Appendix A for convenience.[1] Generating Company was ordered to "make a showing of the facts necessary to enable the Commission to find and determine whether" among other things "the rates and charges for the service to Georgia Company * * * are unduly discriminatory," and whether the same rates and "charges to Georgia Company * * * are un-

[1] The facts related in the order are not in evidence. Neither is Respondent's answer in evidence. The facts will be found from the evidence of record.

just and unreasonable; *and if so* what rate the Commission should order Generating Company to file." (Italics added). It was further ordered that

> "Generating Company shall show its costs of rendering the service to Georgia Company, * * * using, among other things, (i) a prudent investment rate base with the deduction for accrued depreciation computed on the basis of straight line depreciation; (ii) a fair rate of return; (iii) taxes actually to be paid over the life of the contract."

The contract was for a 25-year period. It further provided:

> "* * * This showing shall be made for the first two units in commercial operation: (1) for the calendar year 1954 using actual experience insofar as data are available for the period the two units shall have been in commercial operation and estimates based upon actual experience for the remainder of that year; (2) for every fifth year thereafter *for 25 years,* by use of the same figures with adjustments to reflect changes in net investment, return, and federal and state income taxes, and other changes which are known and measurable with reasonable accuracy. * * *Generating Company shall show its revenues from Georgia Power for the same years based upon the same operations under its Rate Schedule FPC 1." (Italics added).

In the order setting the hearing herein issued March 17, 1955, Generating Company was ordered to open and close in the presentation of testimony. Counsel for Respondent in opening stated: ".....in following that procedure, we do not concede, of course, that there is any burden of proof on South Carolina Generating Company in regard to the issues here." Continuances were granted until May 18, 1955, when evidence was first taken.

JURISDICTION

The following finding and conclusion is adopted from Respondent's Brief:

> "The South Carolina Generating Company's transmission line from its Urquhart plant to the Georgia line is a facility used for the transmission and sale of electrical

energy at wholesale in interstate commerce. Therefore the Commission has jurisdiction of this facility and of the contract under which the Respondent sells electric energy at wholesale to the Georgia Power Company. All of the property of the Respondent is located in South Carolina. It and its parent company, the South Carolina Electric & Gas Company, are subject to regulation by the South Carolina Public Service Commission, and the Federal Power Commission's jurisdiction is limited to the regulation of the wholesale contract between the Respondent and the Georgia Power Company." (p. 2)

The jurisdiction of the Commission over the sale by Respondent to Georgia Company is established by all the evidence of the transaction, and is conceded by all parties. That the sale is at wholesale for resale in interstate commerce and that the transmission of electric energy to Georgia Company is in interstate commerce is established and conceded.

THE POSITION OF THE PARTIES

The following is quoted from Respondent's Brief:

"The South Carolina Generating Company pleads in its Answer to the Commission's Order that its rates and charges to the Georgia Power Company under the contract in issue here (Item A) are not unjust, unreasonable or unduly discriminatory within the meaning of the applicable statute.

"It contends that the contract was freely made between two independent power companies acting at arms length and is mutually advantageous to the Georgia Power Company and to the Respondent and its parent, South Carolina Electric & Gas Company. By reason of this contract the Georgia Power Company is able to obtain a large block of power without any capital investment and at a saving of some half million dollars a year to its customers. The Respondent contends that since the contract results in this saving to Georgia, the requirement of the statute that rates be neither unjust nor unreasonable has been met. But even if the return on the contract is measured by a cost of service formula the rates are not unreasonable or unjust.

"Since the Commission has jurisdiction of only one rate, since the Respondent is the wholly owned subsidiary of South Carolina Electric & Gas and since Electric & Gas and Georgia Power serve entirely different areas, the case presents no question of undue discrimination. But if it does, the obligations assumed by Electric & Gas justify any difference in the rates which may be found between the Respondent's contract with Georgia and the one with its parent.

"The Georgia Power Company defends the contract as fair and beneficial to it (Branch, Ex. 1, pp. 3-4, R. 97-107. 114-115, 144-5) at the time it was made and now. This position the Georgia Power Company clearly stated to the Georgia Commission in its letter of May 5, 1954 (Davis, Ex. 10)." (pp. 3-4)

The following is quoted from Brief of Staff Counsel:

"At the hearing, Clyde F. Boland, Chairman, and other representatives of the South Carolina Commission entered their appearance and Mr. Boland submitted a statement expressing approval of the contracts of Generating Company, contending that no comparison should be made between the Georgia Power contract and the State regulated E&G contract, that in any case the contracts are not discriminatory in view of the burdens on E&G, and that the rate to Georgia Power was reasonable (Tr. 404-407). He also submitted a copy of the South Carolina Commission's order of January 2, 1952, purporting to approve the two contracts (Tr. 408). The South Carolina Commission presented no evidence and took no part in the examination of witnesses.

"The Georgia Commission was represented by Walter R. McDonald, Commissioner, and Mr. N. Knowles Davis, Chief Engineer. Mr. McDonald made a statement to the effect that the Georgia Power contract was discriminatory and unfair. Mr. Davis took part in the cross examination of Respondent's witnesses and presented testimony designed to show that the fixed charge element of $7.20 per kw per year in the capacity charge to Georgia Power was in excess of the cost of service and should be eliminated". (Ex. 43). (p. 7)

The following is quoted from Answering Brief of Georgia Public Service Commission:

"It is the position of the Georgia Public Service Commission that the rate charged by South Carolina Generating Company for delivery of power to Georgia Power Company is unjust, unreasonable and unduly discriminatory within the meaning of those terms in the Federal Power Act.

"The Georgia Commission contends this to be true by reason of the substantially higher rate charged Georgia Power Company than South Carolina Generating Company charges either of its other two customers (South Carolina Electric and Gas Company and E. E. dupont De Nemours & Company, Inc.), that reasonableness of the rate charged Georgia Power Company can be measured neither by what an alternate source of power would cost Georgia Power Company (including other alleged advantages to that Company), nor by what an alternate capitalization of South Carolina Generating Company and corresponding fictitious results of operation would prove. The Georgia Commission contends that undue discrimination exists in rates and charges as between the customers of the Generating Company which subjects the customers of Georgia Power Company to an undue disadvantage. The Georgia Commission further contends that the rate differentials not only reflect undue discrimination, but in addition establish as a fact the unreasonableness of the rate charged Georgia Power Company.

"Respondents take the position that the difference in the rates, being subject to separate regulatory jurisdiction, does not, in and of itself, create a discrimination. The Georgia Commission contends, however, that each of the three rate levels were initiated and filed by Respondent without rate hearings or investigation by any regulatory body to determine reasonableness, and furthermore all three rates relate to the same service provided from the same facilities. The fact that the South Carolina Public Service Commission has jurisdiction over one or more of the rates of South Carolina Generat-

ing Company does not deprive the Federal Power Commission of jurisdiction to find that undue discrimination exists.

"The Georgia Commission further contends that the rate applicable to the Georgia Power Company contract should be measured in the manner adopted by the parties to the contract."

The position of the Commission's Staff is set forth in a 65-page brief. The Index shows the following main points:

I. The rate for the service to Georgia Power Company is unreasonably high.

II. The rate is unduly discriminatory against Georgia Power Company, and this confirms its unlawfulness.

THE ISSUES

The rate investigation order (in clause A paragraph (2)) specifies that the sale of electric energy to the Georgia Company "is a sale at wholesale in interstate commerce, subject to the provisions of Sections 205 and 206 of the Federal Power Act." Paragraph (3) questions whether "the rates and charges for the service to Georgia Company as set forth in Generating Company's Rate Schedule FPC No. 1 are unduly discriminatory within the meaning of Section 250 of the Federal Power Act and unlawful." Paragraph (4) questions whether "the charges to Georgia Company provided for by such rate schedule are unjust nd unresonable." Section 205 (a) of the Federal Power Act declares any "rate or charge that is not just and reasonable" to be unlawful. Subsection (b) of Section 205 forbids any public utility in "any transmission or sale subject to the jurisdiction of the Commission" to "(1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." Section 206 (a) requires the Commission to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force" whenever the Commission "after a hearing had upon its own motion or upon complaint, shall find that

any rate, charge, or classification * * * is unjust, unreasonable, unduly discriminatory or preferential."

Two issues are thus raised:

(1) Are the charges to Georgia Power unjust and unreasonable?

(2) Do the charges make or grant undue preference or advantage, or cause undue prejudice or disadvantage?

The problem is as narrow as the contract to furnish electric energy to Georgia Company because that transmission and sale is the scope of interstate commerce by Respondent. The problem differs from a rate case which tests a tariff of rates and charges to numerous interstate customers. This problem is whether *one sale* to *one customer* under a particular contract is unjust and unreasonable, including testing whether the differences from other transactions which are intrastate are unreasonable differences, i.e., unduly discriminatory. To fix the interstate rates herein would be to fix the specific price of electric energy from Generating Company to Georgia Company. It would not be determining a schedule of rates of general application to numerous customers as in the more usual rate case, because Respondent has but one interstate customer. This sale was made under a specially negotiated arrangement to deliver electric energy to another electric utility located in another state; not as the result of fulfilling a public utility duty to serve any and all consumers or customers within its service territory. The basic inquiry here is not what generally applicable rates to the public are just and reasonable, because this Respondent makes but three sales;[2] but whether this particular sale to the Georgia Company is just and reasonable? This basic distinction has a bearing upon the nature of pertinent proof.

The order initiating this proceeding, as quoted above required proof relative to the 25-year contract period, namely, cost of service data for 1954 and for every fifth year there after for 25 years. The Respondent actually furnished more than was required.[3] The test issue—just and reasonable—was to apply to the whole 25-year contract and period, not

[2] 75,000 kw to Georgia Company, 45,000 kw to its parent (S. C. Company), and 30,000 kw to the AEC Hydrogen Bomb Project.

[3] The first five years—1954, 1955, 1956, 1957, 1958—were also furnished, and much of the detail for 1961 was also shown.

just to some one test year. The test went to "its revenues from Georgia Power for the same years";[4] to its "prudent investment rate base with the deduction for accrued depreciation computed on the basis of straight-line depreciation" for the 25-years, not just for one year; and to "taxes actually to be paid over the life of the contract," not just computed for one year. The evidence must be evaluated with respect to meeting these particular requirements of the Commission's order.

The Organization of Generating Company

This story is best told in the words of Respondent's witnesses:

"A. In common with other electric utilities experiencing phenomenal growth in the post-war period, South Carolina Electric & Gas Company had been faced with the necessity of adding frequently to its generating capacity; in view of this condition, it had on order a turbo-generator unit, boiler and other plant equipment, the size unfixed, delivery of the unit being scheduled for August, 1952. Several sites for this proposed plant had been under consideration. With substantial steam electric facilities in the north and southeast extremities of its system, it had become apparent that the next such facilities should be located in the west-central area and extensive location studies had been made by the midsummer of 1950. Special consideration was given to a site near Branchville, South Carolina, since this location was particularly well suited for the South Carolina Electric & Gas Company's system and would result in minimum transmission loss. However, before definite site determination had been made, an announcement was made by A.E.C. that it expected to locate an enormous Hydrogen Bomb Project in the territory served by the Company, about fifty miles west of the Branchville site. Early in December, 1950, representatives of duPont Company, prime contractors for the Savannah River Project of A.E.C., contacted Electric and Gas officials in regard to construction and operating power supply for the Savannah River

[4] Clause (c) of this Order Initiating Proceeding.

Project. They were advised that Electric & Gas then had on order a turbo-generator unit, and that it would build a plant of sufficient size to supply all of the A.E.C. power requirements.

"Q. Mr. McMeekin, will you state whether or not you were actively engaged in a discussion with the duPont rep-representatives concerning the possibility of evolving a contract for the power supply for the A.E.C. Savannah River Project.

"A. I was, and from the outset of such discussions I was assigned the task of developing a satisfactory rate for such power supply. On January 13, 1951, duPont was given an initial proposal for its operating power requirements.

"Q. What was the reaction of the duPont representatives to the initial proposal insofar as rates quoted?

"A. The duPont people indicated that the quoted rates were too high and that they were looking into other possible supplies, including the possibility of supplying all such requirements from their own plants. It was also sensed by the Company's representatives that the negotiations with duPont were being somewhat colored by arrangements which A.E.C. was making with Electric Energy, Inc., for its power supply at Paducah, Kentucky, and that a very important factor in the Paducah rate had been brought about by special financing for that project in which the ratio of debt to total capitalization was approximately 95%." (Witness McMeekin in Exhibit 5, p.4)

"It became obvious that normal financing would not produce a plant which could sell power at a price which would sell to AEC. It was but a normal and logical step to resolve this problem in approximately the same manner it had already been worked out for AEC by Electric Energy, Inc. * * * Quite obviously Electric & Gas because of its Indenture restrictions could not finance such a plant on the basis contemplated. Hence the formation of a separate corporation was necessary." (Witness Costello, Executive Vice President, in Exhibit 6, pp. 2, 3)

By financing Generating Company on the basis of 75% mortgage bonds, 15% ten-year notes, and 10% common equity held by the parent S. C. Company, a rate to AEC, based on such high-debt ratio financing, which would satisfy AEC was made possible, and a contract to supply 30,000 kw of electric energy was ultimately executed.[5] To secure the business from AEC the S. C. Company (the parent) was required to make certain burdensome commitments. These were listed in Exhibit 5 by Witness McMeekin as follows:

"1. It was necessary for the Electric & Gas to make certain improvements in its transmission system so that service to A.E.C. would be of unusually high quality.

"2. It was necessary for Electric & Gas to guarantee deliveries to A.E.C. under certain conditions. In case of an outage of one unit, such guarantee would result in an 83% loss of its contracted for capacity, of 45,000 kw, whereas such a one-unit outage would result in only 50% loss for the Georgia Power Company.[6]

"3. It is also the obligation of the Electric & Gas to continue to supply the Generating Company's commitments to A.E.C. in event of outage of both units other than that of a force majeure type of outage. Under this commitment, Electric & Gas not only suffers 100% loss in its contracted for capacity with the Generating Company but also is committed to furnish 30,000 kilowatts of capacity to A.E.C."

Other factors considered in reducing the rate to duPont were:

(1) It was a government plant.

(2) It was bringing in a large number of people into the service area of the S. C. Company.

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[5] The contract with E. I. duPont de Nemours and Company (on behalf of and for the risk and benefit of the U. S. Atomic Energy Commission—AEC) is Exhibit 12. As duPont was merely the agent for AEC reference to AEC will usually be made and references to duPont will refer to AEC. The parent actually had to put up about 15% equity. (T. 527) The duPont contract was not signed until after the plant was put into operation in 1954, namely, on March 9, 1954, effective on January 11, 1954, with the first power being delivered on February 10, 1954. (T. 544, 567, 568)

[6] Only 75,000 kw capacity is left. AEC gets 30,000 kw, Georgia Company gets 37,500 kw (50%), and S. C. Company gets the balance of 7,500 kw. (T. 470)

(3) We wanted to meet competition from public power agencies, such as Santee-Cooper and Clarks Hill, which AEC had contacted regarding supplying power to the Hydrogen Bomb Project.[7]

The same factors were otherwise stated:

"The fact that they were building up our residential load."

"We wanted to establish character by getting it (this business) in our own territory." "They had brought in a tremendous amount of new business." "We were in competition with public agencies in trying to get the Atomic Energy business." (T. 558, 576)

Those things were considered and "we came up with $19 as being something we felt we could justify taking into consideration and sell duPont." That figure had the components of $15.30 (the same as in Georgia Company contract) and $3.70.[8] The initial rate quoted to duPont was higher than the rate finally negotiated.[9] Witness McMeekin testified to the effect that his company would not have agreed to sell to Georgia Company at the rate given to the AEC. The benefits to South Carolina Company to be derived from selling to Georgia Company are not deemed to be equal to those received from selling to AEC.[10] When the Generating Com-

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[7] T. 526

[8] T. 558; Witness Gordon also evaluated the AEC contract as having an influence upon system credit. "If the Company had not been able to build the Urquhart Plant, even though the 35% equity capital ratio might have been more quickly achieved, it would have been regarded as unfavorable by the investor, if the Company was not able to take care of the requirements in its own territory." T. 213

"Overall, it seems to me to have been to the advantage of the company, looking ahead for its cost of money, to have built the Urquhart Plant. It was necessary to have this kind of capitalization in order to be able to get the AEC contract. Therefore, it was in my opinion in the interests of the company to adopt this unconventional method for the advantage that it gave, and, therefore, it obviously should be the goal of the company to gradually achieve a conventional average equity base * * * It reduced the cost of money for the Generating Company. It increased the cost of money for the parent, but it would be my estimate that the advantage, the savings to the Generating Company more than offset the added expense to the parent company, including the intangible factor taken seriously into consideration by the investor that South Carolina Gas and Electric Company was able to meet the requirements in its own service area.

Q. "You say more than offset. How much more than offset?

A. "That I don't believe anybody in the United States with all the IBM machines, could answer for you exactly." T. 215

[9] T. 563

[10] T. 575, 576

pany's plant capacity is not required by the Georgia Company or by their own system, AEC has been allowed by special agreement to take, and have taken, in excess of the 30,000 kw contract maximum because taking at a load factor of more than 100% by AEC, tends to reduce costs.[11] This benefits Georgia Company and S. C. Company. The decision to build the two unit plant (called Urquhart) was made before Georgia Power Company came into the negotiations, and before the exact kw requirements of AEC were fixed. In fact, the second unit had been ordered in the spring of 1951, and this plant was not dependent on selling to Georgia Company.[12] The capacity could have been used in their own system without the Georgia sale.[13] The special financing (90% debt ratio) was used to permit quoting to AEC an acceptably low rate for electric power. It was recognized then that the parent (S. C. Company) must undertake special burdens to sell AEC because of the special financing of the new subsidiary to make the low rates feasible. But as of the hearing date Witness McMeekin testified that "the overall project was desirable by the company," i.e., creating and financing Generating Company as against the extra burdens.[14]

In this setting of facts, the Georgia Company contract was negotiated.

Negotiation of the Contract with Georgia Power Company

Respondents' witnesses present the facts as follows:

> "The Georgia Company had become aware of our plans to construct a plant adjacent to the Savannah River Project Area and of the type of anticipated financing. Georgia Company officials advised representatives of Electric & Gas that they were contemplating the construction of a one unit steam station near Augusta, and that they then had on order a 60/66 MW unit for use at that station. Consequently, it was suggested that a cost study be made, considering the feasibility of some arrangement whereby Georgia could secure its required capacity for the Augusta area from the Generating Com-

[11] T. 577
[12] T. 490, 539-541
[13] T. 492
[14] T. 574

pany station, rather than construct its own plant, inasmuch as it appeared that with the special financing available to the Generating Company, a considerable saving would be available to Georgia Company.****** In order to determine the overall economics of the two conditions and the possible saving to Georgia Company, under the two conditions, it was necessary to compare the plant cost and other cost factors under the two different propositions, that is, the plant as Georgia Company would have to finance it, and the plant as Generating Company planned to finance it. Estimated plant costs on these two bases were prepared by Gilbert Associates, Inc., engineering consultants for Generating Company, and by Southern Services, Inc., engineering consultants for Georgia Company. In general, these estimates were in fairly close agreement. Several meetings between the Georgia Company and its engineering representatives and the Generating Company and its engineering representatives were held during the spring of 1951 to resolve the differences in the estimates." (Witness McMeekin in Exhibit 5, pp. 5, 6.)

"It was generally agreed that an equitable split in savings between the two costs would be the proper approach. It was the opinion of the representatives of both parties that a more equitable contract could be written if the contract were based on a two-part rate, namely, demand and energy. The demand charge was to be based on estimated plant cost and other fixed charges, including operating labor, with proper escalation provisions, and the energy charge was to be based on actual fuel and maintenance cost. After much negotiation and taking into consideration other factors, it was finally agreed that a capacity charge of $22.50 per KW per annum, based on the then estimated plant and other operating costs, would be an equitable one; this resulted in an estimated savings to Georgia in capacity cost of $5.38 per KW per annum, or a total annual saving of $403,500. **** Based on present day fuel cost and present load factors of the Georgia load, it is estimated that the savings accruing to Georgia would be in the order of $175,-

000 to $200,000 annually—in addition to—$403,000 per annum in capacity cost." (Witness McMeekin in Exhibit 5, pp. 6, 7, 9)[15]

"It was agreed that Georgia would obtain 75,000 KW on the high side of the station step-up transformer bank and since the guaranteed rating of the turbo-generator was 75,000 KW at its 13.2 KV terminal, the agreement to deliver 75,000 KW net to Georgia on the 115 KV side of the station step-up transformers represented a considerable concession."

The contract charges were negotiated upon agreed bases, including contract capacity charge of $15.30, of which one element was computed to amortize 90% of the debt and return 8% on the assumed 10% of equity, and the other element was the operations component of $4.80. Both of these were subject to escalation for variation of estimated and actual investment, and of variations of expenses, including operating, general and administrative, and taxes, from actual expenses.

The other component of contract charges was the energy charge including cost of fuel, maintenance, and related taxes. This was estimated at $.00315 per kwh.

Witness Ready describes the third element of the negotiated $22.50 per l.c. contract charge as follows:

"The contract provides for an additional capacity charge of $7.20 per kw which is not related to any costs to be found on the books of South Carolina Generating Company. This amount was negotiated as a sharing between Generating Company and the Georgia Company of substantial economies estimated as accruing to the Georgia Company under the contract as compared with the construction and operation of a generating station of its own. These substantial savings are primarily attributable to the assumed 90% debt financing from which Georgia derived the benefit, and it should be borne in mind that the parent company, if we brush aside the

[15] The $22.50 was negotiated before the split into $15.30 and $7.20 was computed and agreed on. T. 519. The $22.50 studies used in negotiating did not take into account the costs to the parent, S. C. Company, resulting from special financing and the AEC's sale. "The term 'cost' as contemplated by the parties to the contract has reference to the outlays necessary to do the job rather than the term as it may be used in an accounting sense." Ready, Exhibit 2, p. 2.

artificialities of corporate entity, is actually the vendor which financed this project and in so doing the parent had to provide equity leverage for this debt. In other words, there are costs on the books of the parent company which should be taken into account in addition to the costs to be found on the books of Generating Company, and these costs may be roughly measured by the spread between the cost of servicing equity capital and the average cost of servicing total capital to the extent that capital funds of the parent company had to be provided exclusively from equity to provide such leverage." (Exhibit 2, p. 4)

"The computation of taxes on income included in the projection of the cost to serve the Georgia Company, which is Statement No. 1 filed with the Commission on January 15, 1955, is related to the assumed 6% return of the net investment. For this purpose it was assumed that the deduction for interest would not be the amount of interest to be paid by Generating Company, but would be the interest payable by Generating Company if its debt were 50% of its capitalization, consistent with capitalization ratios implicit in the 6% return. As alluded to previously in the discussion of the additional capacity charge, the dislocation in the capital structure of the parent company will have resulted in a disproportionately high equity ratio with a correspondingly low debt ratio and the loss of interest deductions in computing its income tax, to the extent of the difference between actual interest of Generating Company and the interest used in computing the tax element in its cost to serve. The result is essentially the *system* tax." Exhibit 2, pp. 5, 6)[16]

[16] Witness Gordon supported the necessity to maintain normal system capitalization ratios under cross-examination. T. 217-238. "It has cost it increased costs of money because the debt ratio is so high. The bonds, for example, are rated Baa. If the debt ratio were lower, the bonds would be rated higher, in my opinion, and the bond money would cost the company less. * * * the bonds would be rated A * * * if the ratio were, let's say, 31 per cent * * * equity * * * and that the debt ratio was down to approximately 52 or 53 per cent." T. 238. It increased the cost of bond money to the consolidated system, and of preferred and common stock. This system has gained a plus factor by having met the requirements of the U. S. Government in its territory. It "has more competition considerably than the average privately owned utility company * * * through the Santee-Cooper operation and the Clark Hill project." T. 239

The same witness summarizes the several commitments, which the parent, S. C. Company, was required to undertake to obtain the financing of its wholly owned subsidiary as the instrumentality to generate and transmit the electric energy to AEC, to Georgia Company and to the South Carolina distribution system, as follows:

> "As sponsor of the Generating Company and as one of its three power customers, Electric & Gas had made a number of very significant commitments to purchasers of project securities, vendors, and to Generating Company, which are of very great value to the latter company and of potentially great cost to Electric & Gas. Although it is difficult to assign a monetary value to these intangible contributions by the parent company, they should be given due weight, together with the more measurable costs arising from the previously mentioned displacement in capitalization ratios; in any comparison between the rate to Georgia Power Company which includes the $7.20 per kw additional capacity component and the rate to South Carolina Electric & Gas Company which does not. ***** The parent company initiated a number of major equipment orders and remained as a contracting party after Generating Company was organized.
>
> "In bond and note purchase agreements the parent company guaranteed the payment of commitment fees, if the securities were not sold.
>
> "In bond and note purchase agreements the parent company was obligated to provide any excess funds required to complete the station or upon failure to do so to provide sufficient funds to redeem outstanding debt.
>
> "Under the Indenture and note purchase agreements the parent company is guarantor for the payment of principal and interest on the bonds and notes until after certain earnings conditions are met for twelve consecutive months of operations.
>
> "Under bond purchase agreements the parent company agrees to make up any deficiency in insurance in the event that the station is destroyed or partially destroyed.

"In the parent company's power purchase contract with Generating Company, the parent is obligated to supplement its payments for contract capacity to the extent necessary to provide an eight per cent return on Generating Company equity after expenses, taxes, interest and debt amortization.

"In this power contract the parent agrees to be responsible for any contract capacity reduced or cancelled by any of the other contracting parties, and in the event of such cancellation at the request of the parent company, to pay for such capacity at the same rate as the party relinquishing same.

"Under this power purchase contract the parent company is also obligated to successors or assigns of Generating Company.

"Under the power contract between Generating Company and duPont, to which the parant company is a party, the parent company is obligated to supply any deficiency in electric service to duPont unless such deficiency results from force majeure." (Exhibit 2, pp. 7-9)

Witness McMeekin summarized the savings to Georgia Power Company as follows:

"1. The overall efficiency of this plant is approximately 10% higher than that proposed by Georgia. Consequently, fuel consumed per KWH is approximately 10% less.

2. No fuel tax applicable as contrasted to a three percent tax on fuel burned in Georgia.

3. If Georgia Company had constructed a one unit station at Augusta, as they proposed, they would have suffered a 100% loss in capacity, with its attendant voltage troubles in the event of an outage of this unit, whereas under the contract with Generating Company, they have only 50% loss in event of outage of one unit and it would be very improbable that they would ever suffer 100% loss of capacity.

4. Reduction in maintenance cost due to maintenance allocation being on a kilowatt-hour basis produced is another saving. Since the plant production is con-

siderably higher than that proposed on the Georgia plant, the unit maintenance cost will be correspondingly lower.

5. Under the Georgia ownership plan, it would have been necessary for Georgia to maintain minimum load requirements during certain off peak hours when it would not have been economical for them to do so, whereas under the Generating Company contract they are allowed to reduce their take below minimum load requirements on steam units provided other loads on steam units are sufficient to make up this deficit. This factor has proven of considerable advantage to Georgia." (Exhibit 5, pp. 8, 9)

Georgia Company profits by the transformer losses (approximately 458 kw under full load conditions) under outage conditions. That some of these benefits also inured to others did not destroy or reduce them.

The contract further provided for reducing the plant cost by the savings calculated to result when additional capacity to the plant was added. Originally computed at $200,000 it was in fact credited to Georgia Company at $581,000. This credit was made effective as of the date of the first contract deliveries which was about two years before the third unit went on the line.[17]

The Georgia contract has a recapture clause. Witness Costello describes it as follows:

"Section 4.03 of the agreement provides for the recapture, at will, by Generating Company of not over 25,000 KW upon twelve months notice. Section 4.04 provides that all of the contract demand not already taken under Section 4.03 may be recaptured upon thirty months notice. In a system which is expanding as rapidly as ours the cost of new plants is an ever present and saliently impelling factor. When Plant Urquhart ws originally constructed, only two units were ordered—each of 75,000 KW capacity. Before these were completed, a 100,000 KW unit was ordered. The first two units were completed last year (1954), and work is already well in progress on the installation of this third unit. Already

[17] Exhibit 5, p. 10; T. 544.

plans are being formulated for the construction of still another plant to support the ever-increasing load of the system. Quite naturally this requires us to assess at short intervals the cost of constructing these new plants against the return we derive from the capacity at Urquhart used by Georgia Power. When this latter amount reaches a point below the former, in the absence of some other impelling motive of which I am not currently aware, recapture will follow as a rational and normal result. And I will also say that increased costs evidenced in just the few years since this contract was executed have brought these two factors already dangerously close together." (Exhibit 6, pp. 4, 5)

Witness McMeekin explains the advantage of the recapture clause in cross-examination:

"* * * if the plant cost and other factors contributing to cost go up sufficiently to where it would be a saving to our rate payers to recapture this contract, of course, it will be to our advantage to do it. We certainly always attempt to do the most economical job we can."

The converse was said to be true. However, cancellation is subject to bondholder approval, *and approval by this Commission.* Testimony indicated that if the revenues from the contract became smaller the point of time when recapture would be cheaper than additional construction of generating capacity to enable the S. C. Company to continue to render adequate service within its service territory might be reached sooner. Counsel for Respondent states in rebuttal that to point out such a logic of the situation was not to make a threat of cancellation.[18]

Regarding financing Generating Company testimony pointed out that in connection with financing 75% long term bonds and 15% ten-year notes it was necessary for S. C. Company to assume additional intangible obligations and guarantees beyond supplying the equity capital, so that the true cost to the parent company of the financing of the Generating Company, which is applicable to measuring the cost to serve Georgia Company, is higher than the bare cost of money

[18] Testimony also pointed out that there is no cancellation or recapture clause in the contract with the AEC.

incurred by the system, which is measured by the costs incurred during the three year period 1951-1954.

Total capitalization at the end of 1951 of $84,516,000 (before there was any subsidiary) was divided into:

63.25%	debt
10.87%	preferred
25.88%	common equity
100.00%	

After financing Generating Company with 90% debt, and increasing the equity ratio of the parent company to compensate for the impact on the system credit of the high debt ratio financing of Generating Company, the system ratios at the end of 1954 were:

62.83%	debt
9.40%	preferred
27.77%	common equity
100.00%	

These 1954 system ratios are comparable to the 1951 ratios of the parent company before there was any subsidiary company. To accomplish these 1954 capitalization ratios, despite the dilution of equity caused by the 90% debt financing, the parent company was required to issue a disproportionately greater proportion of equity securities, namely, 72% of the increase in parent capital was common equity, only 18% was preferred and only 10% was debt. These ratios are almost the reverse of the high debt ratios of the financing of the Generating Company.[19] The result in terms of parent capitalization were:

52.64%	debt (reduced from 63.25%)
12.35%	preferred (increased from 10.87%)
35.01%	common equity (increased from 25.88%)
100.00%	

These parent company capitalization ratios were thus again approximately at the electric utility industry normal levels of 50% debt, 15% preferred, and 35% common equity. The additional system cost of money up to the end of 1954 is

[19] Statements 4 and 4(a) of Exhibit 3.

measured by the disproportionately larger ratio of equity capital issued by the parent company. But such extra cost of money must continue until the parent, S. C. Company, had by the further issuance of disproportionately greater ratios of equity capital fully corrected the system dilution of capitalization, i.e., until the system capitalization reached the industry norm of 50% debt, 15% preferred, and 35% common. The evidence presents the estimates of these additional costs to serve[20] based upon the progressive and gradual injection of new capital at a rate of approximately 10%, which represents the 10-year electric industry average growth factor. It also represents this system's experience in plant growth[21] and in electricity sales.[22] Respondent shows that by 1960 the system capitalization ratios will have been brought into line with industry-wide normal averages, as mentioned above, marking the end of the additionl costs of money involved in the cost to serve under study here. This is reflected on Table I, in the last column entitled "Actual Cost, %," where it is shown that 1961 marks the high point of money cost to the system—6.3536%, which cost declines each year thereafter, once the system capitalization has been stabilized. The projection of capital growth in Statement 7 of Exhibit 3 is perhaps the basic exhibit in this case. From that projection, grounded and controlled as outlined above, come all the computations of capital elements entering into cost to serve during the 25 year contract period, including capital ratios affecting forward computations of Federal Income Tax expense as an element of operating expense.[23]

Statement 7(c) of Exhibit 3 performs a very important function in the estimates of cost to serve. It demonstrates the relationship between system finance costs and the finance costs of Generating Company, chargeable against th first two units at the Urquhart Station, i.e., one-half of which is applicable to service to Georgia Company. This part of the Respondent's estimates of cost to serve is the most im-

[20] The 1955 figures were based upon current calculations of load increase.

[21] Statement 7(a) of Exhibit 3

[22] Statement 7(b) of Exhibit 3

[23] Mr. Davis for the Georgia Public Service Commission moved to strike all of this evidence and testimony. But, of course, it was exactly the type of relevant evidence, which the Commission's order directed to be presented.

portant part of the evidence of the true costs incurred in providing electric energy from the Urquhart Station. The testimony of the sponsoring witness, Ready, is quoted, as follows:

> "*Statement 7(c)* (Exhibit 3) entitled 'Segregation of System Capital and Related Annual Costs Between the First Two Units at Urquhart Station and the Remainder of the System' is designed to demonstrate why the weighted average system cost of money, rather than the cost to be found on the books of the Generating Company, is the proper measure of the costs to the system in connection with the two unit project at the Urquhart Station. For this purpose we have taken the year 1961 as representative. The statement is divided into four sections, the first section showing the system growth capital in use during 1961, the cost of which including related taxes is 11.9743%[24] The second section shows the capitalization of Generating Company in that year applicable to the first two units at the Urquhart Station. Due to the preponderance of debt, the average cost on the basis of capital ratios to be found on the books of the Generating Company is 9.1868%. The third section is headed 'Displacement' and refers to parent company capital which is displaced, or out of its normal capitalization ratio position, if we consider the system capitalization ratios as normal for that year, due to the necessity of providing leverage for the capital of the Generating Company in connection with the first two units. The fourth section entitled 'Non-project' represents system capital which is unaffected by the project financing. Thus the statement shows system growth capital of approximately $178,000,000, project capital of about $23,000,000, non-project capital of about $140,000,000 and approximately $14,000,000 of capital in limbo, that is, occupying temporarily and in-between status wherein the money is actually used for non-project purposes, but its cost is abnormal due to the influence of project financing. Therefore, we have allocated a part of the annual cost to the project and a part to non-project use.

[24] Composed of "weighted finance rate in 1961—6.3536% plus the tax factor of 5.6207%. Exhibit 3, p. 6.

The amount allocated to non-project use is the normal or average system cost of such capital measured by applying the average system rate to the total dollars. The remainder, which amounts to $650,000, is the excess of cost for such capital arising from project financing. This is the detriment to be found in the costs of parent company capital and we have applied this amount as an additional cost for units 1 and 2. The result of adding $650,000 to the $2,142,000 of cost previously determined results in a total of $2,792,000 of system costs for Generating Company capitalization for units 1 and 2 for the year 1961, resulting in a composite rate of 11.9744% which is substantially the system rate, the minor difference being obviously due to dropping fractions. If we apply this rate to the rate base applicable to Georgia, we have a return and related tax of $1,324,452." (Exhibit 3, pp. 7, 8)

The Position of the Georgia Power Company

The Georgia Company was not a party to the proceeding but Mr. Harllee Branch, Jr., President of Georgia Power Company was a witness for Respondent and stated the position of his company.[25]

Early in 1951 the Georgia Company ordered a turbo-generator unit of 60/66 mw and bought a site for a generating plant near Augusta, Georgia. At about the same time representatives of Georgia Company were negotiating with S. C. Company for 75,000 kw of electric energy for distribution in the Augusta area. This decision was based upon the following considerations:

"(a) The cost of power from a two-unit plant is cheaper than the cost of power from two single-unit plants built at approximately the same time and in the same locality;

(b) Plans for the South Carolina plant, only about two miles from our proposed site, were further advanced, and it was felt that the needed power supply for the Augusta area could be obtained more quickly and more cheaply from that source;

[25] Exhibit 1. Staff Counsel objected to this testimony.

(c) Special financing, not available to our Company was possible for the South Carolina plant. The South Carolina Company offered to share these benefits, together with other savings in construction and operating costs, with our Company.

(d) Our Company was, and had been for a number of years, involved in a large expansion program so that it was considered desirable to limit our capital outlays wherever possible without prejudicing our service or rates. This could be done by purchasing our power requirements for the Augusta area; and

(e) It was possible for our Company to obtain additional service protection by contracting for power from a two-unit plant with the right to utilize one-half of whatever capacity was available at the plant in the event of a unit failure."

On cross-examination, Mr. Branch emphasized the advantages to Georgia Company of the contract with Generating Company. He stated that he was fully aware of the capture provision, that it was not unusual, and that it represented a fair and acceptable arrangement. The avoidance of obtaining and investing capital in a new plant by Georgia Company was a real advantage, as the company has been expanding plant investment at the rate of $35 million to $40 million per year for 10 years.

"If someone else would build the plant for me and do it on terms that would compare favorably with my cost, I was delighted to have them carry a part of my burden for me.[26]

"My motivation * * * was to put off as long as we could the investment and expenditure of money in that area in the light of our other capital burdens."[27]

"That is, where I said we had been facing a big capital expansion program. And I might say I think it is a direct advantage to my ratepayers to void as much of that capital expansion as I can because of the fact that we thereby less dilute our capital structure and have to acquire or obtain less new financing and the results

[26] T. 98
[27] T. 105

of that ultimately, I believe, is a saving and a benefit to them as well as to the company * * * We were able in this particular case to have a plant built at a money cost * * * and our 75,000 kilowatts * * * at a money cost appreciably more favorable than would have been possible under our capitalization ratios to build the same capacity. To that extent it was not just a benefit to the company, but it was a benefit to the ratepayer in that any expense which enabled us to hold our rates and our expenses at the existing level, was more favorable than one that might have compelled a rate increase. * * * There is no question in my mind that we are getting a lower expense in the operation of the plant attributable to the cost of money."[28]

Estimates then made showed cost of financing the Urquhart capacity to be $22.50 per kw against $27.80 per kw for the same capacity in a plant built by Georgia Company. Later computations after costs went up showed about $25 per kw against $31 per kw for Georgia's plant. The witness still thought he had made a good contract and would do it today! This was emphasized several times.

"A. My understanding, as I tried to indicate by my prior testimony, was that they had that special financing in contemplation and it was one of the things that motivated us in seeing if we could get under what somebody here referred to as that special financial umbrella.

"Q. My point is: Was your participation necessary to raise the umbrella, as you understood it at the time?

"A. I certainly say this, and that is the reason I am a little embarrassed about these proceedings in addition to feeling that we made a good contract. I know, because my people sat in on some of those discussions, that investors who financed this plant took Georgia Power's contract into consideration in their willingness to finance this plant. So I was informed by my people, and I am therefore embarrassed and concerned if the contract should be altered or set at naught, for the impact * * * maybe I ought not to say this, but

[28] T. 98, 99

I am seriously concerned * * * that that might have on any future efforts to do what I understand this Commission would like to see these independent companies do, and that is integrate their systems and build capacity one for the other wherever it is cheapest.

"Q. Then it is fair to say, is it, that you feel your participation made possible the financing and the method that was adopted and the construction of a two-unit plant?

"A. The second unit. I think they could easily have financed on the H-bomb contract and their own service the one unit. They may have financed a two-unit plant, but certainly ours did enter into the willingness of the investors to finance the second unit. I think that is a fair statement."[29]

The Nature of Respondent's Showing Regarding Cost to Serve

Without raising any question of law, such as to the legal duty of Respondent to prepare and file specified evidence, or to open and close, and without argument, either during the hearing or in its briefs, as to what party must sustain the burden of proof in a rate investigation proceeding pursuant to Section 206(a) of the Federal Power Act, the Respondent made the showings it was ordered to make for the 25-year contract period. Respondent's exhibits furnish estimates (beyond the actual data for the partial year 1954) for 1955, 1955, 1956, 1957, 1958 (the first 5 years) and for 1963, 1968, 1973 and 1978 (the four remaining 5-year intervals). In accordance with Commission Opinion No. 264, provisions for future taxes arising from accelerated amortization are treated as elements of cost in the period in which taxes would otherwise have been incurred. Net cost to serve the Georgia Company varied from a high of $3,568,000 in 1955 (for 459,900,000 kwh) to $2,767,300 in 1978 (for 525,600,000 kwh) or a cost per kwh from .00776 in 1955 to .00527 in 1978.[30]

Revenues from the Georgia Company contract varied from $3,262,300 in 1955 to $3,485,900 in 1978 or a per kwh rate of

[29] T. 125, 126.

[30] Only 255,400 kwh were generated in 1954. Statement 1, Exhibit 7, Statement 3 of Exhibit 2 presents the comparison on a 6% return basis.

.00709 in 1955 to .00663 in 1978. In 1963 the contract revenues will exceed the cost to serve ($3,355,200 minus $3,295,600 equals $59,600 in excess of a 6% return for that year); but cumulatively the 6% return will not be exceeded until 1970. On that showing the contract in the last nine years of the contract period would produce a revenue in excess of a 6% return, depending upon the stability of price and estimated costs and upon how accurate the estimated 3% straight-line depreciation rate turns out to be and upon the modifications of tax impact upon earnings during the 25-year period. Stated differently, the same showing means that in the year 1962 the contract revenues for the first time will produce a 6% rate of return (6.06%), and cumulatively calculated the contract revenues will have produced a 6% rate of return (6.04%) for the period the contract has run by the end of the year 1970.[31] for 1955 the lowest rate of return earned will be 4.97% (cumulatively 4.81% by the end of 1955); and for 1978 the highest rate of return earned will be 13.95% (cumulatively 6.95% by the end of 1978). By the end of the 25-year contract period the investment in plant (rate base) allocated to the service of the Georgia Company will have been depreciated by the application of a 3% straight-line rate of depreciation from $14,021,000 in 1954 to $4,146,000 in 1978.[32] On the showing for the 25-year period of a straight-line 6% return basis, as an average cost of money, which cost varies from year to year, a 50 percent system equity-debt ratio was used as a system average ratio of equity to debt for part of the 25-year contract period, which average ratio is consistent with the 6% straight-line return used for the 25-year contract period, which period the Commission's order required the Respondent to use in showing whether its contract with the Georgia Company will produce during the 25-year period just and reasonable rates and charges to the Georgia Company. The 6% straight-line rate of return and the 50% system equity-debt ratio is also consistent with the 3⅝% rate of interest, which approximates

[31] Exhibit 7—Statements 1 & 2; Exhibit 2—Ex. VI, Statement 3. As actual operational data cover only part of 1954, the evidence necessarily represents estimates of plant investment, working capital, materials and supplies, expenses, taxes and revenues from the contract with the Georgia Company for the 25-year period.

[32] Exhibit 2—Statement 3.

the cost of debt money under the circumstances of system financing here involved.[33]

The comparison of contract revenues (five-year intervals, 1955 through 1978) with the cost to serve the Georgia Company on the actual system cost of money basis is as follows:

Year	Actual System Cost of Money Basis (000)	Contract Revenues (000)	Actual Cost Rate (5)
1955	3,456	3,262	5.9306
1958	3,495	3,291	6.2076
1963	3,371	3,355	6.2716
1968	3,158	3,406	6.1442
1973	2,968	3,454	6.0829
1978	2,773	3,486	6.0479

The high point of cost would be in 1961[34] when the rate of 6.3536% would be produced. In that year the deficiency of contract revenues to produce $1,020,030 net income after taxes at a 6% rate of return is $29,698, and the deficiency to produce $1,140,534 net income after taxes on the actual system cost of money basis (6.3536% in 1961) is $133,744.[35] Prudent investment rate-base was supported by detailed cost estimates and experienced cost figures agreed upon by the engineering representatives of S. C. Company and the Georgia Company. Having agreed upon capital costs, which were borne out in experience to date, engineering and other representatives of the S. C. Company and the Georgia Company agreed upon a method of computation of charges, which is shown to be closely correlative to the cost to serve over the 25-year contract period. This is illustrated by comparing the computed revenues to be received by the Generating Company from the Georgia Company under the contract (rate schedule). The net cost to serve the Georgia Company and the revenues from the Georgia Company contract are shown for the 25-year contract period on two bases of comparison. One compares revenues to costs estimated on an average 6% rate of

[33] Exhibit 3—Statement 7—25-year Projection, from 1951, of Growth of System Capital, etc.

[34] Exhibit 3—Statement 9. This basis is alternatively used in the showings made. The actual system cost of money is one standard of measurement of cost to serve against contract revenues. See Table I Below.

[35] Statement 10.

return basis (6% cost basis). The other compares revenues to the computed actual system cost to serve the Georgia Company, using (not the average 6% rate of return but) the actual system cost of money. The results are shown on Table I as follows:

TABLE I

Year	(1) Deficiency 6% Cost Basis (000)[a]	(2) Cost to Serve 6% Cost Basis (000)[b]	(3) Contract Revenues (000)[c]	(4) Cost to Serve Actual System Cost of Money Basis (000)[d]	(5) Deficiency Actual System Cost of Money Basis (000)[e]	(6) Actual Cost Rate %[d]
1954	414	3010	2596	2777	181	5.679
1955	306	3568	3262	3456	194	5.93
1956	252	3500	3248	3448	200	6.04
1957	208	2476	3268	3474	207	6.125
1958	164	3455	3291	3495	204	6.207
1959	119		3319	3512	193	6.283
1960	75		3328	3503	175	6.348
1961	30	3366[e]	3337	3471	134	6.3536
1962	(14)		3346	3421	75	6.311
1963	(59)	3296	3355	3371	16	6.272
1964	(103)	[f]	3365	3325	(40)	6.238
1965	(148)		3376	3280	(94)	6.209
1966	(192)		3386	3239	(147)	6.185
1967	(236)		3396	3198	(198)	6.163
1968	(279)	3127	3406	3158	(248)	6.144
1969	(324)		3416	3119	(297)	6.129
1970	(368)		3426	3081	(345)	6.115
1971	(412)		3435	3042	(393)	6.103
1972	(456)		3445	3005	(440)	6.092
1973	(501)	2954	3455	2968	(486)	6.083
1974	(545)		3461	2929	(532)	6.074
1975	(589)		3467	2889	(578)	6.067
1976	(632)		3473	2850	(623)	6.06
1977	(676)		3480	2812	(668)	6.054
1978	(719)	2767	3486	2773	(713)	6,048

[a] Exhibit 2—Statement 3
[b] Exhibit 7—Statement 1. See Statement 3 (Exhibit 2) which gives also prudent investment rate-base and percent of return produced by contract revenues.
[c] Exhibit 3—Statement 9
[d] Exhibit 3—Statements 8 and 9. Statement 8 also shows Federal and State Income Tax deductions and rates.
[e] Exhibit 3—Statements 10 and 11
[f] The blank years were not interpolated.
[g] Column (1) is the remainder after subtracting the lesser of Columns (2) and (3) from the greater.
Column (5) is the remainder after subtracting the lesser of Columns (3) and (4) from the greater.
Variations occur by reason of rounding out figures to nearest thousand.

The actual system cost of money basis is established by Statement 7 (Exhibit 3) and is reflected in column 5 of Table I above (and in Exhibit 3, Statement 9). This is an alternate showing (see the detailed comparison in Statements 10 and 11) to the straight-line 6% rate of return development of system cost to serve. Statement 7 (Exhibit 3) shows the 25-year projection (from 1951) of system capital growth and related annual cost and taxes on income. The system debt/equity ratios are projected beginning with 63.25% debt, 10.87% preferred and 25.88% common in 1951, and reaching about 50% debt ratio, about 15% preferred, and about 35% common equity ratio in about 1960, from which point forward to the end of the contract period these system ratios remain about the same.[36]

To reach and maintain such system ratios, common stock is increased in the projection from $21,875,000 in 1951 (25.88% ratio) to $487,100,000 in 1978 (34.98% ratio). Segregation of system capital to project (Georgia Company service) and non-project is shown on Statement 7(c)—Exhibit 3 of which page 1 shows year 1961, page 2 shows year 1954. Analysis of system cost of dislocation of capital by the issuance of 90% debt by the subsidiary (Generating Company) is shown on page 1 of Statement 7(c) for 1961 as $650,120 involving $13,994,100 of dislocation.

The industry (Class A and Class B electric utilities) average capitalization ratios are shown on Statement 5 for 1951, 1952 and 1953 as:

Year	Long Term Debt	Preferred	Common
1951	49.22	13.45	37.33
1952	48.68	13.04	38.28
1953	49.83	12.77	37.40

Statement 6, Exhibit 3, shows the revenues, average net plant and rate of return for the industry for the year 1954 as follows:

Electric Utility Operating Revenues	$6,541,107,000
Electric Utility Operating Income	1,353,319,000
Average net plant	21,657,940,000
Rate of Return	6.2%

[36] Exhibit 3—Statement 4 shows system changes in capitalization 1951-1954, which establishes the basis for capital growth projection. See statement 4(a) for summary.

The foregoing is an abbreviated analysis of Respondent's exhibit showing. It is also necessary to summarize the testimony of Respondent's witnesses regarding the preparation, significance, and evaluation of the exhibits which they introduced.

Capital Growth

Before the subsidiary, Generating Company, was organized and financed on the basis of 90% debt and 10% equity, the S. C. Company (the parent) had at the end of 1951 capitalization ratios of 63.25% debt, 10.87% preferred and 25.88% common equity. There were no subsidiaries then. By the end of 1954 consolidated ratios were 62.83% debt, 9.40% preferred, and 27.77% common equity. To accomplish the increase in consolidated equity ratio from 25.88% to 27.77% and the decrease in debt ratios from 63.25% to 62.83%, the parent, S. C. Company had increased its equity ratio from 25.88% to 35.01% and decreased its debt ratio from 63.25% to 52.64%, to provide system leverage. Thus the 90% debt ratio financing of Generating Company caused the parent, S. C. Company to increase its equity ratio disproportionately in order to maintain a satisfactory financeable credit for the system. To provide funds for investment in the common stocks of its wholly-owned subsidiaries the parent company was required to sell its own equity securities and to retain earnings. 72% of the increase by the parent company in capital was equity capital of the parent between 1951 and 1954.

During this period the changes in ratios were as follows:

For the System	For the Parent (S. C. Company)
62% Increase in new debt	10% Increase in debt
7% Increase in preferred	18% Increase in preferred
31% Increase in common	72% Increase in common

Beginning with approximately $84,517,000 capitalization at the end of 1951 divided into 63.25% debt, 10.87% preferred, and 25.88% common equity, the increase to $138,613,000 at the end of 1954 was divided into 62.83% debt, 9.40% preferred, and 27.77% common equity. After 1955 an annual straight-line increase in capital is used, the factor of 10.3%

straight-line growth factor representing the growth factor from 1945 through 1955, after excluding the investment in the first two units of the Urquhart Station devoted to the service of Georgia Power Company, so as to measure growth for territorial service only.[37]

The projection of capital growth gradually increases the system equity ratio to 35% and the preferred stock ratio to 15%, which reduces the consolidated debt ratio to 50% as the normalized system ratios for the balance of the contract period. Statement 5 of Exhibit 3 shows that such ratios represent the approximately average ratios of all Class A and Class B electric utilities in the United States in 1951, 1952, 1953, as reported by this Commission's publication entitled "Statistics of Electric Utilities in the United States." These ratios for the system are required for financial soundness. Such ratios are deemed necessary by witness Gordon as a financial expert to permit future financing of anticipated growth.

In computing the annual cost of money, 3.625% was used for debt money, 4.60% for preferred, and 10% per annum. Income tax rates of 4½ for the State and 52% for the Federal were used. Weighted finance rates range upward to a peak of 6.3536% in 1961 when the tax factor is 5.6207%.

Displaced Capital

By 1960 the system common equity ratio reaches approximately 35% and preferred reaches 15% in 1961. The year 1961 is used to compute the segregation of system capitalization and related annual costs between the first two units of Plant Urquhart, which is devoted to the service of the Georgia Company (sometimes referred to as the "Project") and the remainder of the system (or "non-project"). The system cost of money in that year is 11.9743%. The project cost of money is 9.1868%. Statement 7(c) shows the segregation and costs of money, and calculates the additional cost on the capital of the parent company, which resulted from project financing with its high debt ratio and the necessity for the parent company to provide leverage for the project capitalization. Cost of money is segregated between project and

[37] Exhibit 3—Statements 4, 4(a) and 7(a).

non-project use. Non-project use has the normal or average system cost applied to $140,000,000 non-project capital. As to $13,994,100 of displaced system capital, the study shows that its cost is increased by reason of the project financing at the high debt ratio by $650,120, which added to direct project costs of $2,142,505 gives $2,792,625 of the system costs for the project (units 1 and 2).[38]

Applying this composite actual system cost of money rate of 11.9743/% to $11,061,000 (rate base in 1961) devoted to the service of the Georgia Company produces a return before taxes of $1,324,500, of which $702,800 is return at actual rates, and taxes on income on actual system rates is $621,700, of which $59,600 is State Income Tax and $562,100 is Federal Income Tax. In that year on the actual system cost of money basis the deficiency of equity return after payment of taxes is $133,744, and on a straight-line 6% return basis is $29,698.[39] On the projected actual system cost of money basis shown in Statement 9 of Exhibit 3, the Georgia Power contract revenues are not sufficient to cover system costs until 1964 and the accumulated deficiency is not overcome until 1971. Statement 10 of Exhibit 3 was developed expressly to contrast the two showings (6% straight-line return basis and actual system cost of money basis). Exhibit 3 reflects the taxes, [39a] the overall return and equity return of the columns in Statement 10 and proves the soundness of the tax figures. The tax effect on the system of the high debt-ratio in financing the project resulted in an increased cost to the parent company, because the parent being required to increase its equity ratio (to correct the system ratios) would have less interest to deduct in computing Federal income taxes and would have to pay higher income taxes than it would have to pay if the system could have maintained normal ratios. The computation of system cost included the cost of normalizing the tax component of cost by using, after 1961, as system ratios the national average of Class A and Class B electric utilities. The interest deduction in 1961, for example, resulting from the normalizing of the income tax impact upon system earnings

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[38] Exhibit 3, pp. 7 and 8—W. J. Ready and Statement 7(c) page 1. Page 2 of Statement 7(c) gives the same computation for the year 1954.

[39] Exhibit 3—Statements 10 and 11.

[39a] Statement 11 of Exhibit 3

during the 25-year contract period, is $200,475 on the 6% straight-line return basis and $183,907 on the 6.3536% (actual system cost of money) basis. Actually, the abnormal impact is not removed except gradually by 1961 so that system earnings were reduced abnormally by the capital displacement in all years before 1961.[40]

It was testified by Witness Gordon, a partner of Kidder, Peabody & Co., that without the aid of the S. C. Company, its subsidiary, Generating Company, could not have been financed. The commitments assumed by the parent company were essential. The 90% debt ratio used to finance the Generating Company caused the parent company to have increased costs of financing its additional capital, and resulted in an abnormal ratio of common stock financing by the parent company. The total cost of financing the system will be greater until the system ratios are returned to about 50% debt ratio, about 15% preferred and 35% common equity ratio.[41] The cause of such higher costs is the high-debt-ratio financing of the subsidiary, Generating Company. The 50% debt-ratio, 15% preferred ratio and 35% common equity ratio are recommended as the conservative normal average for this system, especially by reason of its present and potential future competition from public power bodies in the territory, and because of the effect of higher operating costs which widely varying hydro-electric output causes. Hydro-electric generation is a substantial part of the system's capacity. To enable the system gradually to reduce debt ratio to a conservative 50% ratio (with common equity at 35% and preferred at 15% ratios), the system must have a return of at least 6%, particularly because this system's cost of raising capital "for some years" will amount to somewhat more than the industry average return which was 6.2% on average net plant for 1954 and approximately the same in 1953. As an expert in financing costs, Witness Gordon testified also that the cost of debt would be between 3½% and 3¾% for some time in the future, with preferred stock capital costing between 4½% to 4¾% or 1% to 1¼% higher than debt capital, and common stock capital needing to earn 10% or more to assure success of future common equity financing.

[40] Exhibit 3, Statement 11.
[41] Exhibit No. 4—Witness Gordon's direct testimony.

Citing correlative market prices, he testified that a 9.5% return on common equity was "minimum bare-bones cost of financing," and that an adequate margin of earnings over and above such figure was required "to provide reasonable assurance as to the successful financing" of the system. Testifying as to required rates of earnings on an over-all basis, he said:

> "Assuming capitalization ratios at objective of 50% bonds, 15% preferred stock and 35% common stock, such rates of earnings on overall bases would range from about 5.93% to 6.09%. However, in order to attain consolidated capitalization ratios of 50% debt, 15% preferred and 35% common this company must finance over the next several years with larger proportions of equity securities, and, therefor, the overall rates of earnings needed to assure successful financing would be in excess of the range of 5.93% to 6.09%.
>
> "On an overall basis I believe that earnings of at least 6% are necessary to afford reasonable assurance for successful financing of South Carolina Electric & Gas system in the near future."

The record contains no testimony contra to that of Witness Gordon. Respondent based its showing substantially on the bases recommended by this expert financial witness.[42]

The Nature of the Evidence of the Commission's Staff

Witness Goubleman's direct evidence was admitted as Exhibit 19. He sponsored the statistical Exhibit No. 18, as supplemented by Exhibit 18-A. Witness Kenneth L. Smith, Commission Supervisory Auditor, testified in Exhibit 44 and sponsored a 2-page Exhibit No. 45, entitled "South Carolina Generating Company—Cost of Service (Georgia Power Company Sales)—Year 1956." This single exhibit represents the Staff's rebuttal of the cost to serve evidence, shown by Generating Company, for the 25-year contract period of the Georgia Company contract. Witness Smith explains why he presents data for the year 1956 with modifications:

> "Data for the year 1956 were selected to indicate the cost of service which can be expected to be representa-

[42] See T. 200ff.

tive of the immediate future. Beyond the immediate future foreseeable changes in the rate base and other possible changes will undoubtedly alter the results shown in this exhibit.

"While the exhibit is based on data and information relating to the year 1956 in the showing of South Caroline Generating Company, I have made several modifications of the company's conclusions in order to obtain a proper cost of service. A field examination would possibly reveal the necessity of further adjustments. My modifications are summarized briefly as follows:

Item No.

1. The rate of interest capitalized during construction on equity funds has been reduced from 8% to 6% per annum.
2. A composite annual depreciation rate of 2.75% has been applied in accordance with the company's practice in keeping its books and issuing financial reports to investors, in preference to the 3% annual rate claimed by it for rate making purposes in this proceeding.
3. Interest deductions used for the purpose of computing the Federal income tax allowance are those for the actual financial structure of this company in preference to an assumed capitalization proposed by the company.
4. A depreciation rate of 3.25% was used in computing the Federal income tax allowance, representing the rate claimed and expected by the company to be allowed by the Internal Revenue Service, for income tax purposes. The Company used 3%.
5. The company's claimed cash working capital has been reduced by eliminating natural gas purchased from the operating expenses for which cash working capital must be provided and by making a deduction for working capital funds provided to the company through income tax accrurals collected from customers in advance of actual payment thereof to the tax collecting agency."

Witness Smith also testified as to form of rate and says:

"Notwithstanding that changes in the cost to serve Georgia Power in subsequent years are certain to occur, it is my opinion that the Commission would be justified in prescribing a fixed annual charge for the present capacity service rendered to Georgia Power by Generating Company. Regulation is a continuing process. No rate can ever be regarded as fixed or appropriate for all time. The propriety and necessity of periodic re-examination is obvious. Such procedure unquestionably is fair and reasonable for all concerned. * * * In addition, the present energy charge provision of FPC Rate Schedule No. 1 would be retained. It would be necessary however, to revise the capacity charge in the future depending upon the changes which may occur in the capacity cost elements."[43]

Describing Exhibit No. 45, Witness Smith Says:

"For use in this proceeding I have proposed Exhibit No. 45, consisting of two schedules, which sets forth the cost of service and rate base related to sales to Georgia Power Company for the year 1956 based on the showing made by the company in this proceeding. An assumed rate of return of 5½% and an assumed Federal income tax rate of 52% were used in computing such cost of service. I am not necessarily recommending, however, that these percentages be adopted for return and tax rates. While their use is provisional in this study, the methods of applying whatever rates are found proper for return and Federal income tax are appropriately illustrated in the Exhibit."

For the year 1956 Exhibit 45 shows the cost of electric energy at $21.769 per kw of contract demand. And Witness Smith recommends that such cost be substituted for the present $22.50 capacity charge in the first paragraph of Section 3.02 of the rate schedule. He also recommends eliminating "the second full paragraph of page 30 of Rate Schedule No. 1 * * * to permit either Generating Company or Georgia Power to petition the Commission for a change in the rate.[44]

Witness Goubleman testified (Exhibit 19) regarding Exhibits 18 and 18-A, showing the nature and sources of the financial data and statistics presented "to furnish the Com-

[43] Ex. 44, pp. 13, 14.
[44] Exhibit 45, p. 15.

mission with comprehensive pertinent data on which it can rely in the exercise of judgment as to the fair and reasonable rate of return for South Carolina Generating Company." Such data include average interest rates and yields, the cost of preferred stocks, earnings, pay-outs, offering prices and earnings-price ratios of common stocks, and capitalization ratios, and financial statistical data regarding S. C. Company, Generating Company and the System. Page 10e, the witness stated, sets forth the composite capital ratios at December 31, 1953 (the latest statistics thereon available) of 25 electric utilities * * * all operating for the period 1946 to date, as shown in Moody's Services, which sold common stock issues in their entirety to the public * * * as being approximately 50% debt, 12% preferred stock and 38% common stock equity. The comparison of the earnings-price ratio of the S. C. Company of 7.2% against the 25-company average 6.3%, he explains as "accounted for in great part by the relatively smaller size of (South Carolina) Electric and Gas, the relative thinness of its common stock, its lower payout of earnings" * * * between 58% and 67% of its availabble earnings.[45] The witness refers to certain language in the *Hope Natural Gas Company* case (320 U. S. 591) as laying down principles controlling his testimony. Included is the language that:

> "By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."

That quotation by the witness is, of course, not evidence, but cites the controlling law of rate regulation, which function is the work of legal counsel, not of financial witnesses. Examining the record to discover what evidence Witness Goubleman furnished to the Commission on the proper "return" about which the *Hope* case quotation speaks, it is found that the witness points out (p. 8) that:

> "Page 11 (of Exhibit 18) sets forth the capitalization and capital ratios of Electric and Gas system as of Dec-

[45] Page 9 of Exhibit 19

ember 31, 1954. At that time debt comprised 62.8%, preferred stock 9.4%, and common stock and surplus 27.8% of the total capitalization,"

and that

"Page 12 (of Exhibit 18) shows the cost of the outstanding debt of Electric & Gas System as 3.46%, and preferred stock as 4.9%."

Such data constitutes competent financial opinion evidence. But nowhere does he give the cost of common equity or compute or recommend how to arrive at the rate of return. He gives no expert opinion evidence as to the "commensurate" return of which the quotation from the *Hope* case speaks.

Witness Smith, the only other Staff Witness, very carefully stated his relationship to the issue of rate of return. As quoted above he assumed a 5½% rate of return. But Witness Smith correctly refrained from testifying or attempting to give expert testimony on the rate of return in view of his accounting qualifications and lack of expert qualifications of record regarding financial evidence. He left for some qualified witness the furnishing of evidence of the components which would establish a 5½% return.

To get from 3.46% debt cost and 4.9% preferred stock cost to a 5½% composite rate of return requires that missing elements of evidence must be supplied, namely, the cost of common equity in terms of a percentage, and the capital ratios to be used as multipliers. Such computation study is normal expert evidence for the purpose and would be subject to be probed by cross-examination. Witness Goubleman is qualified of record to testify on such financial matters. Such testimony from him would have been competent. He is qualified to give expert opinion evidence on this financial issue by furnishing the computation and the requisite component factors to produce a composite 5½% rate of return. He is qualified to support them both under direct and cross-examination. But he gave no such evidence.[46]

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[46] Had he furnished a computation such as follows below, and supported the use of each component this record would have some competent evidence from the Staff on the 5½% "assumed" rate of return, which would have put some substantial evidence underneath Exhibit 45.

Debt (system cost)	3.46%	times 62.8%	=2.17%
Preferred Stock (system cost)	4.90%	times 9.4%	= .46%
Common equity	10.3%	times 27.8%*	=2.87%
			5.50%

* System capital ratios at the end of 1954, as supported by financial evidence of Witness Goubleman.

The missing rate of return evidence is found in the Brief of Commission Staff Counsel filed October 18, 1955 and in the "corrected" brief filed October 27, 1955. The missing 10.3% "allowance" for common equity appears for the first time in any paper in the case on page 33 of said briefs and the missing components and computations of the 5½% rate of return study using system capital ratios is found on page 40 of said briefs.[47]

It is hardly necessary to remark that the missing "evidence" (component elements) by which the "assumed" 5½% return could be arrived at which are found in Commission Staff Counsel's Brief is not evidence. Even if due process did not require that such financial evidence and computation elements be presented by a witness under oath and subject to direct and cross-examination, the material would be inadmissible because it is not competent opinion evidence, because Commission Staff counsel was not presented on this record as a witness for any kind of evidence and this record shows no attempt to qualify him as a financial expert. Hence his opinion evidence as to the proper components to derive the "assumed" rate of return would not have been competent even had it been offered as evidence under oath subject to direct and cross-examination.

By way of summary then as to the Staff's evidence which is before the Commission, it is pointed out that there is no evidence of or in support of the 5½% rate of return, as computed in the Staff's cost of service. The use of 5½% return stands as Witness Smith left it merely assumed, without proof or evidence. Thus used the computations resulting therefrom have no evidentiary weight respecting any issue here involved. Exhibit 45 furnishes no substantial evidence in support of cost to serve. It is noted that counsel for Respondent made no motion regarding the disposition of evidentiary matter in Commission Staff Counsel's Brief, which is not evidence. However, no such silence by Respondent's counsel, even if it operated as a waiver or concession, can convert material which was never presented or admitted to the record through the sworn testimony of a competent wit-

[47] Respondent's Reply Brief, page 19, notes that "the components of the 5½% return" were not "known until they appeared in the Staff's brief."

ness into substantial, competent, relevant and probative evidence, which would support and give substance to the evidence. Hence, the cost to serve figure rests merely upon an assumed rate of return. No cost of service thus derived has any substance. Epecially is this true when the fair rate of return as here is the crucial issue of fact, which must be established by preponderant proof. If this were not true why try the factual issues in a required statutory hearing?[48]

The Evidence Offered by the Georgia Public Service Commission

At the opening of the hearing for the taking of evidence, Mr. Walter R. McDonald, member of the Georgia Public Service Commission, entered his appearance and that of "Mr. N. Knowles Davis, Chief Engineer of the Georgia Commission, appearing on behalf of the Georgia Commission in compliance with the Statutes of the State of Georgia."[49] In Exhibit 9 Mr. Davis described himself as an engineer with the title of "Chief Engineer." His qualifications relate exclusively to engineering activities as testified by Mr. Davis in Exhibit 9. But at the end of the exhibit he states that he has been admitted to the bar of the State of Georgia. He was permitted to act as counsel and witness.[50]

Besides Exhibit No. 9 relating to Mr. Davis' qualifications, Mr. McDonald sought to introduce a group of letters without any witness sponsoring them as exhibits. As Exhibit 10 these documents were admitted but not as evidence in this case. They were admitted as comprising part of the record as statements made by and to the officials of the Georgia Public Service Commission as part of their position as parties in this proceeding. Exhibit 43 is the direct testimony of Witness Davis.[51] He argues that the "orthodox method" of determining whether rates of public utilities are fair and

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[48] Respondent says at page 11 of the Reply Brief "While Staff Counsel's brief speaks of a 5½% rate 'which is assumed in Commission Staff Witness Smith's evidence' (p. 24), it is fundamental that findings and determinations must be made on evidence, not on assumptions."

[49] T. 10

[50] There has been some reference to the Chairman of the Georgia Public Service Commission, Mr. Matt L. McWhorter. But his appearance was never offered by anyone or entered on the record. Whether he was ever in attendance is unknown to the record. He is not known in person or by appearance to the Presiding Examiner.

[51] Admitted by the Commission on appeal.

reasonable, should not be used in this case because it produces a rate that varies as depreciation reduces the investment rate base. He argues for the use of the contract charges —capacity charges and energy charges—as cost to serve and for the cancellation of the $7.20 per kw charge, "which represents no specific cost of service."

EVALUATION OF EVIDENCE

It is appropriate to sift the evidence as to competence, probative effect, and weight. Inso doing discussion of the basis of reaching the evaluation may be involved.

The Evaluation of the Evidence of the Georgia Commission

The analysis by this Commission's Staff of the position of the Georgia Public Service Commission is adopted.

> "Mr. N. Knowles Davis, as witness for the Georgia Public Service Commission, was of the opinion that the adjustable charge of $15.30 in the Georgia Power contract represented cost and should be used as the basis of rate making while the additional fixed charge of $7.20 represented value of service and should be eliminated (Ex. 43, p. 10). It was his opinion that rates fixed in the ordinary way on the basis of current costs of service were not suitable for this type of service, for costs and rates would necessarily start high and decline over the 25-year period of the contract as the reserve for depreciation increased.
>
> "We do not believe that the record is sufficient to support a finding that the $15.30, even as adjusted, is cost of providing the capacity service. It may be that a field examination by the staff, such as has not been made, might provide such evidence, but that has been impossible under the circumstances.
>
> "Mr. Davis' recommendations go beyond what the staff feels it could recommend under the applicable precedents in another respect. As shown below the Staff's cost of service study demonstrates that current costs are in excess of the $15.30 basic charge as adjusted, or, in other words, fall less than the full $7.20 below the actual billing. To adopt Mr. Davis' view, therefore,

would mean that for a number of years Generating Company would be required to serve at less than the cost of service."[52]

Exhibit 11 summarized the analysis of Power Costs using contract charges. The Georgia Public Service Commission introduced no other evidence or testimony.

The Evaluation of the Evidence Regarding Cost to Serve

The evidence will be discussed in the order of the modifications proposed by the Staff in the methods of estimating the cost to serve.

Interest on Equity Funds during Construction

Whatever the general rule should be in general rate determinations, the Respondent may reasonably use 8% on equity funds to show the realistic cost of serving Georgia Company. Equity funds of the parent admittedly cost approximately 10%. There is no evidence to the contrary. The Staff argues from other cases not from any facts in evidence tending to show that the equity funds used during construction cost only 6%. The claim of 8% for the purpose is more conservative than the uncontradicted proof of record shows the cost of equity money to the system to be to serve the Georgia Company. All of the evidence presented by the Staff regarding the cost of system equity funds shows that 8% is reasonable in this situation to establish Respondent's cost to serve the Georgia Company.

Depreciation.

The commission ordered Respondent to use a straight-line computation. Respondent used 3% for the 25-year contract period. The Staff in its Exhibit 45 for the year 1956 used 2.75%, for expense purposes and 3.25% for tax purposes. Respondent's Controller testified regarding the 3% depreciation rate (for both tax purposes and for expense purposes) as follows:

"However, for purposes of this proceeding, with a 25-year projection in view, it is my opinion that the hazards of infant mortality, due to the proximity of the site to the hydrogen project, and of obsolescence due to re-

[52] Corrected Brief of Commission Staff Counsel, p. 56.

> cent developments in nuclear fuels, should receive more weight than are presently given from year to year on the books. It should be borne in mind that Georgia Power Company apparently regarded it as good business to contract for power at rates which amortize 90% of the cost in 25 years."[53]

On cross-examination he testified that by "infant mortality" he referred to the possible shortening of the life of the enterprise from the normal expectancy due to the especial exposure of the plant to destruction by enemy bombing in view of its proximity to the Savannah River plant of the Atomic Energy Commission. The nearness (15 miles) of the Savannah River Project of the AEC constitutes more than normal hazard both by way of danger of bombing and also from the hazards that might occur in the handling of nuclear materials.

In addition the hazard of obsolescence due to recent developments in nuclear fuels was given some weight in determining that a 3% rate for the 25-year period is reasonable. The use of a 25-year "straight-line rate" precludes annual re-examination of these elements affecting depreciation.

Witness Smith supports his use of 2.75% by 2 pages of legal argument in rebuttal to Witness Ready's testimony. He presented no evidence on depreciation. He argued that because the Respondent was using 2.75% now and because Respondent had not proved that 2.75% was incorrect, 2.75% is the right rate.

This is hardly rebuttal proof. It does not—nor does any fact the Staff presented prove or tend to prove that 2.75% is the reasonable rate to measure straight-line depreciation

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[53] Exhibit 2, p. 7. Staff counsel moved to strike this evidence on the ground that the Controller was not qualified to testify regarding depreciation as he had not "been shown to have any engineering qualifications on service lives of companies, depreciation rates." (T. 618-A) The motion was denied. The witness did not testify on service lives—which is an engineering approach to depreciation. The Staff also introduced no evidence on service lives. By way of rebuttal Respondent's Reply Brief pp. 13-14 points out that "the Staff presented no witness qualified on depreciation" and, hence, Respondent's evidence stands uncontradicted. T. 620 through T. 629. See also T. 517 re the importance of obsolescence. Witness Smith who testified on depreciation is an accountant, not an engineer. He does not have any qualification to testify on depreciation. Respondent's Controller in his official position coordinates technical and engineering advice as it affects the accounting on the books and as such is qualified to give the kind of testimony he gave on depreciation.

for the next 25 years on these two units of the plant. Stated in legal language, there is no evidence in contradiction of the showing made by Respondent that 3% is a reasonable rate of depreciation to measure the reasonable cost to serve the Georgia Company. The evidence presented by Respondent is competent, probative, and substantial. It is the only evidence on depreciation of record and is intrinsically persuasive.

Interest Deductions for Income Tax Computations During the 25-Year Contract Period

Witness Smith in Exhibit 45 used the figure of $210,743 for Federal income tax for the year 1956. He furnishes no figures for other years. Respondent shows $593,900 for that year. In Exhibit 44 Witness Smith explains that he is using "Generating Company's own interest deductions in computing its income tax allowance." He argues that "sound cost accounting" requires that. He suggests that anything else is to use "a synthetic tax allowance not consistent with the underlying facts." He accuses the Respondent of substituting "hypothetical interest deductions." However, both his and Respondent's showings for 1956 are only hypothetical estimates. He argues that Respondent's treatment would "rest on the premise or assumption that the Generating Company is no more than a department of the parent company,"—which by the way is exactly correct! Generating Company, as a wholly owned subsidiary, is the parent company's corporate instrumentality to generate this electric energy and makes these sales. Generating Company was created for no other purpose. Witness Smith recognizes the rightness of this when he testifies: "This (system) approach has merit in some instances."

The system is on test here not this "separate corporate entity," not this "contracting and operating entity." To be unfair to the subsidiary is to take money from the parent. Its entitlement or purpose to file separate or consolidated returns in any particular year or years has nothing to do with what the witness himself recognizes as the basic issue, namely, what tax accounting method "would result in the fairest possible distribution of the tax cost consistent with the existing relevant facts."

Because Generating Company was financed on 90% debt ratio, interest deductions are large and tax allowed as expense becomes small. To maintain financial soundness the parent has issued high ratio equity capital and must continue to do so until system capital ratios are near enough the industry averages of capital ratios to assure competitive investor reception of the system securities. As a result the parent (S. C. Company) has less interest to deduct and the Federal income thus computed would be higher. These are undeniable facts. Respondent's witnesses, as outlined above, presented the realities of displaced capital, the effects of higher cost of money upon the parent, and of the abnormal tax burden cast upon the parent by reason of the high-ratio-financing of Generating Company. The only realistic or fair consideration of the tax problem during the 25-year contract period is its treatment on a system basis. Of course it cannot be known now (in 1956) what actual tax returns will be filed in 1978 or 1973 or 1968 or 1963. Nor does the absence of such certainty matter. This Commission is not concerned with whether these system companies pay the correct taxes year by year. This case is concerned with determining whether the charges paid by Georgia Company will compensate fairly the system enterprise in South Carolina which financed and operates the plant which supplies Georgia Company with 75,000 kw of electric energy, and conversely whether those charges exceed the system's cost to serve Georgia Company. To so design accounting elements as to technically satisfy the subsidiary's "costs," while leaving the parent uncompensated for costs directly resulting from creating, financing (with system credit and financial backing), and managing the generating subsidiary is neither moral nor legal, regardless of how regular and routine the accounting procedures are. To use any other than system ratios in computing interest deductions for income tax expense allowances, to use only the subsidiaries interest deductions and ignore the high-debt-financing effects upon the parent company's tax computations would be to measure the fairness here sought by distorted and untrue or half-true facts. Not to take into account the displacement of capital structure of the system caused by the 90% debt-ratio financ-

ing of Generating Company would be grossly unrealistic and unfair in considering whether the charges to Georgia Company over the 25-year period are just and reasonable to compensate for the cost to serve. The cost to serve is not merely the actual operating costs, which Generating Company pays and accounts for, but the capital costs or financing costs, which everyone agrees must be derived from the system capitalization figures. Interest deduction figures must be derived from these system capitalization figures through the 25-year period (as shown in Statement 7 of Exhibit 3); otherwise the South Carolina retail customers of the parent company (South Carolina Electric and Gas Company) will be required to pay additional rates to make up the parent company's additional income taxes attributable to its subnormal interest deductions on its subnormal debt ratio, because it has been compelled by the high debt-ratio of the Generating Company to maintain a counterbalancing higher than normal equity-ratio.

Depreciation Rate for Income Tax Purposes

Exhibit No. 45 uses the rate of 3.25% for depreciation in computing Federal income tax allowance for the year 1956 because it represents the rate claimed by Generating Company and expected "to be allowed by the Internal Revenue Service for statutory purposes". Witness Smith argues that the use of a lower depreciation rate in computing the cost to serve in this case "would return the company an additional profit over and above the fair return." This argument assumes that (1) the Internal Revenue Service will continue to approve 3.25% for the 25-year contract period; and (2) that this Commission will merely follow the Internal Revenue Service determination, although their basis of determination is for tax purposes not as an element of determining whether Respondent's charges to Georgia Company are just and reasonable. Witness Smith furnishes no evidence to support his legalistic argument. Whether the rate of 3.25% for the purpose would produce a fair result during the 25-year period is not even claimed by the witness. The basic fallacy is the assumption that the determination of the Internal Revenue Service will have any particular effect upon the 25-year contract period showing made by

Respondent. Respondent has supported its use of 3% depreciation for the 25-year period. The burden of contravening Respondent's proof has not been met.

Rate Base

Both plant account and working capital were modified by the Staff.

Plant Account

Except for disallowing $60,538 of interest during construction associated with the use of S. C. Company's equity funds, by reducing the interest rate used from 8% to 6%, the Staff accepts the Respondent's figure for Plant Account for 1956, and the allocation of approximately 50% thereof to the two units of Generating Company's plant which is dedicated to the service of Georgia Company.[54] The total initial plant cost of $27,671,900 was used in Respondent's evidence. A working paper introduced in evidence (Ex. No. 28) shows the method of allocating 50% of total plant to gross plant applicable to service to Georgia Company, after eliminating from the allocation the cost of the transmission line to serve Georgia Company, all of which is applicable to Georgia Company service. The initial plant account applicable to service to Georgia Company is shown as $13,861,900 as of the end of 1954 and average plant account from 1957 on to the end of the contract period is shown as $13,706,800. Net plant in 1954 was $13,662,500 and, after deduction of depreciation reserve (accrued annually at the rate of 3% on a straight-line basis), net plant declines to $3,731,000 in 1978.[55] Depreciation reserves applicable to Georgia begin-

[54] The Staff's Exhibit 45 relates only to one year 1956. It accepts Respondent's figure of $13,704,600 as "average plant" for 1956 from Statement 1(d) and deducts one-half of the $60,538 ($30,369) to obtain the "gross average investment" of $13,674,331. The Staff presented no evidence regarding any other year of the 25-year period than 1956. The use of the $13,704,600 constitutes acceptance of the calculations entering into that figure except the one item. The absence of any evidence by the Staff regarding any other year of the 25-year period leaves Respondent's plant investment figures for other years unchallenged by the Staff, except for the item mentioned.

[55] Depreciation calculation is shown on Statement 1(b) (Exhibit 7) for 1954, 1955, 1956, and 1957 and future years as follows: $765,900 (allocated to Georgia $383,800) in 1954; $811,900 (406,800) in 1955; $814,000 (407,800) in 1956; and $814,200 ($407,900) in 1957 and future years. Exhibit 7, statement 1(d).

ning with $7,500 in 1953 and $391,300 in 1954 reaches $10,179,700 in 1978.

Working Capital

Respondent's showing of working capital is challenged (as to the year 1956) by the Staff's proposed modifications affecting natural gas fuel allowance and cash for expenses. In 1956 Respondent shows ⅛ of operating expenses as $191,200. The Staff allowed for that year a minus figure of $97,580, after eliminating natural gas fuel and crediting "tax accrual funds", which Staff alleges represent "68% of allowance for the Federal income tax expenses or the portion thereof available for working capital."[56] The Staff introduced no evidence of these items for any years but 1956. In 1956 the Staff shows working capital of $97,820 and total rate base of $12,855,731, after deductions for all proposed modifications. Respondent shows working capital of $386,600 and total rate base of $13,089,200. Respondent shows $785,400 return at 6%. A 6% return on the Staff's rate base for 1956 would be $771,344 or about $14,000 smaller return.[57] The Staff introduced no evidence as to any of those modifications for any other year than 1956.

In making these estimates Respondent held materials and supplies constant at $195,400 from 1956 until 1978.[58] Unless the dollar is never to be inflated anymore before 1978, that is a very conservative estimate for materials and supplies annually for the next 23 years.

The principle of crediting a proper portion of the tax accruals representing advance payments by customers against the cash component of working capital has been recognized in Commission orders. Whether the amount used by the Staff is correctly computed is not shown by evidence. What the proper amount would be in other years than 1956 is not shown by any Staff evidence. What the effect of that

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[56] Exhibit 45, p. 2 Notes (3) and (4).

[57] Statement 1(c) of Exhibit 7. The Staff also argues for a 5½ rate of return which would produce $707,065 return in 1956—$77,287 less return. But as shown in Table 1, above, the 1956 deficiency of contract revenues measured against a 6% return was $252,000 and against the actual cost of money rate was $200,000.

[58] The Staff adopted the figure in 1956.

modification would be on the 25-year showing cannot be determined from this record.[59]

Rate of Return

A 6% rate of return is demonstrably reasonable in testing the reasonableness of the power charges to the Georgia Company. There is no evidence contra to Respondent's evidence of a 6% rate of return as just and reasonable. The staff presented no evidence in support of its assumed 5½% rate of return. But even considering everything said as though evidence, including material in the staff brief, 6% is established as a reasonable rate of return in this case.

The testimony of Witness Gordon, a partner of Kidder, Peabody and Company, is highly competent evidence, and taken alongside of the statistical financial data furnished by Staff Witness Goubleman is very conservative expert opinion testimony. A rate higher than 6% could be persuasively set forth. On the "actual cost of money basis" of Respondent's showing, the actual cost rate is below 6% in only the two years of 1954 and 1955 (Table I).

If a mathematical approach of arriving at fair return is used (which an experienced financial expert such as Witness Gordon, however, does not use) such as staff counsel used in his brief, the judgment factor is pushed back from the rate of return itself to each of the components. It becomes necessary to judge the correctness of each component, of which there are these six:

(1) System cost of debt (for example 3.46%)
(2) System cost of preferred stock (for example 4.90%)
(3) System cost of common equity (for example 10.3%)
(4) System debt ratio (for example 62.8%)
(5) System preferred stock ratio (for example 9.4%)
(6) System common equity ratio (for example 27.8%)

The examples of cost used were supplied in the brief of staff counsel—in the absence of any testimony by any Staff

[59] There is some question on principle as to the crediting of tax cash beyond the ⅛ cash component. Materials and supplies are not the less required or used in maintaining service because tax accruals are larger than the cash component; but in this proceeding, as will appear below, it is unnecessary to debate substituting a tax accrual cash credit for any part of the material and supplies component of working capital. The logical extension of that tactic would create a negative or minus working capital to be deducted from plant account.

witness as to the component facts to be used to compute a fair rate of return. The system capital ratios used were those testified to by Witness Goubleman as of the end of the year 1954. Had Staff counsel been subjected to cross-examination on his financial opinion, one inquiry would have been made as to why he used end of 1954 system ratios to compute a 1956 test-year rate of return. The system ratios for 1955 were: Debt—62.06%; preferred—8.47%; common—39.47%. Had these ratios been used a higher rate of return would have been produced. The 1956 year end ratios were: Debt—57.93%; preferred—7.52%; common—34.55%. Had the 1956 year end ratios been used the rate of return produced for 1956 would have been 5.6883%.[60]

What fairness requires in this case is the determination of components which are normal for the contract period, not merely ratios occurring in any single year. The 25-year contract period ratios are 50% debt, 15% preferred, and 35% common equity, which Respondent supported by qualified, probative, and uncontradicted expert evidence, including Witness Gordon's uncontested expert financial opinion. Staff Witness Goubleman testified to those approximate normal averages of capitalization ratios, namely, debt 50%; preferred 12%; and common 38%.[61] If these normal average system capitalization ratios, which are supported by uncontradicted expert evidence, were used, the rate of return (using the other components, which Staff counsel argued were just and reasonable) produced would be 7.06%—or 1.06% higher than Respondent claims. Further questions on the use of such components are: why should there be used to test the reasonableness of these charges the historical cost of money of the parent company before the 90% debt-ratio financing occurred to radically affect the investor market reaction to the new and changed system capitalization

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[60] Exhibit 3, Statement 7, p. 1.

[61] Exhibit 19, p. 8 and Exhibit 18, p. 10e showing at end of 1953 for the 25 operating electric utilities: 49.8% debt; 12.5% preferred; 37.7% common. Exhibit 7, Statement 5 shows for the end of 1953 for all Class A and Class B electric utilities; debt—49.83%; preferred—12.77%; common equity—37.40%. Indicating the effect of the 90% debt financing to construct this plant upon system capitalization, it is shown that at the end of 1954 the parent, S. C. Company, had capital ratios of debt—52.64%; preferred—12.35%; common equity—35.01% (Reply Brief, p. 10).

ratios? That is, why should 3.46% be used for this purpose? Would it not be more reasonable to use the cost of debt capital specifically employed to finance this construction, such as cost of debt during the construction period (1952-1954, which is 3.98%, or the cost of all debt financed since 1952 (when this project was begun which is 3.87%. Respondent argues (Reply Brief, p. 13) persuasively that the cost of 3% debt money to the parent in 1950—long before this high-debt-ratio financing was even conceived or could possibly effect the cost of system debt financing—is not appropriately calculated into the system cost of debt to be used as a component of the computation of the rate of return.

It is necessary to conclude that 3.46% is not a fair cost of debt component; but that between 3.50% and 3.75% as testified by Witness Gordon would be fair. It is also necessary to conclude that system ratios at the end of 1954 are not fair and reasonable ratios for this purpose; but that system ratios averaged between those resulting immediately after the 90% debt-ratio financing (such as 62.83% in 1954) and the normalized system ratios calculated to be reached in 1961 (such as 50% debt, 15% preferred and 35% common equity) alone would produce fair and reasonable components for a mathematical computation of a fair rate of return. As Statement 7 shows the 25-year projection of growth capital, it appears that capital ratios such as 1958 of debt 54.7%; preferred 12.53%; common equity 32.77%, or 1959 of debt 52.56%; preferred 13.53%; common equity 33.91% would be the reasonable system ratios to be used for this case.[62] There is no substantial difference between the parties as to what figures to use for the cost of preferred and the cost of common equity.

In this case it is not necessary to compute a specific rate of return to be prescribed, as it must be concluded from all the evidence (including treating staff counsel's proposals as though competent financial expert opinion evidence) that

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[62] Using an average debt cost of 3.625% and the 1958 ratios with the other components—4.9% for preferred and 10.3% for common—would produce a return of 5.98%. To use 1959 capital ratios would produce more than a 6% rate of return.

the showing made by Respondent regarding rate of return is reasonable and must be accepted.[63]

Summary of Conclusions Regarding the Cost to Serve in 1956

Two of the Staff's modifications (so-called) of the Respondent's showing for the year 1956 are accepted, namely, the recomputation of the 12½% of operating expenses, after deducting the natural gas fuel purchased, and crediting 68% allowance for Federal income tax expense against the remaining working capital figures. As shown on Exhibit No. 45 that gives net working capital of $97,920.[64]

The Respondent's average investment of $13,704,600 is accepted, without deduction of 2% of interest capitalized on equity funds, allowing 8% capitalization to stand.

Depreciation reserve as calculated by the Respondent at 3% per year is used in lieu of the $2.75% depreciation figure, included in the Staff's calculation. Total Rate Base is, therefore, $12,800,420 in lieu of $12,855,731 used by the Staff and $13,089,200 used by Respondent. Return at 6% is shown as $768,026 instead of return at 6% of $785,400 as calculated by Respondent or return calculated by the Staff at 5.50% of $707,065, as shown on Exhibit 45. Operation and maintenance are the same for Respondent and Staff. Depreciation of $407,800 at 3% is used as calculated by Respondent in lieu of depreciation of $372,985 as calculated at 2.75% by the Staff. Total cost of service of $3,482,726 is derived instead of $3,500,100 shown on Statement 1 of Exhibit 7 by Respondent or $2,982,040 shown by the Staff in

[63] A study of T. 675 through 685 will demonstrate that both the witness and staff counsel were fully aware of Respondent's three-fold position and its grounds of support, i.e., a straight-line 6% return is reasonably required, a cost of debt capital of about 3.625% is the reasonable cost applicable to the cost to serve Georgia Company, and a system 50% debt ratio, with preferred at 15% and common equity at 35%, should be used for computing the realistic Federal income tax burden on the system during the 25-year period. These are the reasonable system components for determining a fair rate of return. The cross-examination demonstrates that the Staff was well aware of the nature of rebuttal proof that would be required, even though staff counsel suggests otherwise in his motion for leave to file rebuttal brief filed December 21, 1955. Regarding whether surprise could exist, see Exhibit 44, p. 8 where Witness Smith argues against the 50% system debt ratio for tax computation; Exhibit 2, p. 5, Exhibit 7—Statements 1(d) and 2(a); Exhibit 3—Statements 7(b) and 7(c); T. 883-A, 890, 933, and 943. Even this list is not exhaustive.

[64] Respondent does not question either of these.

Exhibit 45. Revenues from the Georgia Company are $3,247,700 as shown on Statement 2 of Exhibit 7. Following the cost classification of Exhibit 45 energy cost of .002844 instead of .0028926 is found. The average cost per kwh of .00746 is found instead of .00750 shown by Respondent on Statement 1 of Exhibit 7. Capacity cost is $28.444 per kw instead of $21.769 calculated by the Staff in Exhibit 45. Average revenue per kwh is .00696 as shown on Statement 2 of Exhibit 7. As shown by Respondent the average cost to serve per kwh reduces annually from .00776 in 1955 (the first full year) to .00527 in 1978; and the revenues likewise reduce from .00709 per kwh in 1955 to .00663 in 1978. In about 1963 revenues for that year at .00681 per kwh will slightly exceed the average cost to serve per kwh which are shown as .00669.

It is not possible from this record to set out the exact annual cost to serve either in dollars or per kwh after reducing working capital, including crediting tax accruals against cash and materials and supplies in determining working capital.

The effect of reducing the rate base from $13,089,200 to $12,800,420 or $288,780 is to reduce the return in 1956 from $785,400 to $768,026 or $17,374. If each return figure shown by Respondent for the other years of the 25-year period is commensurately reduced the remaining cumulative return would not exceed a 6% return on the declining rate base until approximately 1969. From this comparison it is evident that the showing made by Respondent is subject to but very slight reduction and for the purposes of determining the justness and reasonableness of the rates and charges paid by the Georgia Company are substantially accurate. The modification of the method of calculating the working capital and the reduction thereof has but a minor effect upon Respondent's showing of deficiencies of revenues during the first half and more of the 25-year contract period.

The findings and conclusions hereinabove summarized are set forth on Table II below:

TABLE II

Rate Base & Return

	Year 1956	*Source*
Plant:		
Gross Average	$13,704,600	(Stat. 1(d), Exh. 7)
Less: Depreciation	1,002,000	(Stat. 1(d), Exh. 7)
Average net plant	$12,702,600	(Stat. 1(d), Exh. 7)
Working Capital:		
Material and Supplies	$ 195,400	(Stat. 1(d), Exh. 7)
Cash	45,725	Cf. Ex. 45
Credit for tax accruals	(143,305)	Cf. Ex. 45
Net working capital	$ 97,820	
Cost to Serve Georgia Company		
Total Operation and Maintenance	$ 1,529,600	(Stat. 1, Exh. 7)
Depreciation at 3%	407,800	(Stat. 1, Exh. 7)
Taxes: Other than Income	119,500	(Stat. 1, Exh. 7)
Income—State	65,000	(Stat. 1, Exh. 7)
Federal	593,900	(Stat. 1, Exh. 7)
Return	768,026	(Stat. 1, Exh. 7)
Credit for rents	(1,100)	(Stat. 1, Exh. 7)
	$ 3,482,726	
Revenue from Georgia Company	$ 3,247,700	(Stat. 2, Exh. 7)
Average cost per kwh (466,500,000)	$.00746	
Average revenue per kwh (466,500,000)	$.0069665	

FINDINGS AND CONCLUSIONS

Upon the evidentiary record herein and after considering the arguments and contentions of the parties in their briefs,[66] the following further findings of fact and conclusions of law are made:

1. South Carolina Generating Company, Respondent herein, was organized under the laws of South Carolina and financed by South Carolina Electric and Gas Company, as a wholly owned subsidiary, for the purpose of financ-

[65] This table is purely illustrative. The Commission's Order required a showing to be made on a 25-year contract period basis and Respondent made such a showing. Due process requires that rebuttal evidence meet the force of that showing on the entire period—not on any one test year. Proof and decision must not attempt to modify the basis of proof fixed by the Commission.

[66] Rebuttal Brief filed by Commission Staff Counsel on December 21, 1955 and Reply to said Rebuttal Brief filed by Counsel for Respondent on January 16, 1956 have been examined by reason of the public interest, although appropriateness of the Rebuttal Brief is subject to question.

ing, building, owning, and operating the Urquhart steam generating plant near the Savannah River Project of the Atomic Energy Commission (AEC). The parent company desired to contract with the AEC to supply the electric energy requirements of the Hydogen Bomb Plant near the Savannah River within its service territory. To be able to quote rates sufficiently low to compete successfully with public power agencies, such as Santee-Cooper Power Authority and Clarks Hill Dam, for the contract with AEC, for which E. I. duPont de Nemours and Company is agent, it was deemed necessary to create the Generating Company, so that high debt-ratio financing, not possible for the parent company because of restrictions in its indentures, could be used, and, thereby, reduce the operating rates and charges. The testimony of Respondent's witnesses regarding the organization of the Generating Company and the negotiation of the contract with the Georgia Power Company, hereinabove recited, is uncontradicted by any evidence, and is found to be the accurate portrayal of the facts recited. The financing and the favorable interest rates obtained by the Generating Company would not have been possible without the equity invested in the subsidiary, the several guartees and financial commitments, undertaken by the parent company. The lower operating costs obtained by the subsidiary were at the expense of higher financing costs to the parent, in addition to the guarantees and commitments on behalf of the subsidiary undertaken by the parent.

2. Generating Company contracted for the 150,000 kw capacity of its plant by 3 contracts:
   (1) With AEC (duPont agent) for 30,000 kw (Exhibit 12)—the duPont (AEC) contract;
   (2) With parent company for 45,000 kw (Schedule attached to Item A)—the parent company contract;
   (3) With Georgia Power Company for 75,000 kw (Item A)—the Georgia Power contract.

   The evidence regarding these contracts, hereinbefore reviewed, is uncontradicted and is found to be the accurate recital of the facts presented. The presentation of

the facts regarding the contract with the Georgia Power Company by its President, Harllee Branch, Jr., as hereinabove recited, is uncontradicted, and is found to be the accurate portrayal of the facts recited. Specifically the following facts are found regarding the 3 contracts for electric energy:

(a) The duPont (AEC) contract and the parent company contract sell electric energy at lower rates than the Georgia Power contract provides, namely, the energy charge is the same for all but the capacity charges vary as follows:
Georgia Power contract .....$22.50 per kw,
duPont (AEC) contract .....$19.00 per kw,
Parent company contract .....$15.30 per kw.
The charges are subject to the same adjustments in the 3 contracts.

(b) The duPont (AEC) contract provides for guarantees of delivery by parent company, which the Georgia Power contract does not provide; but the Georgia Power contract creates a priority for Georgia Company over the parent company under certain outage conditions. Recitals hereinbefore made regarding these contracts are accurate and are also found to be factual.

(c) The Georgia Power contract gives to the Georgia Company the benefits and advantages recited by the witnesses as hereinbefore set forth, including the testimony of the President of the Georgia Company.

The Georgia Power contract is mutually advantageous to the Georgia Company and its rate payers and to the S. C. Company and its rate payers. There is no evidence on this record that any one or more of the modifications of the Georgia Power contract suggested or recommended on this record would be advantageous to the Georgia Company or its rate payers. The logic of the facts of record is that a reduction of the charges by Generating Company to Georgia Company might with more likelihood bring about a recapture of the 75,000 kw capacity (with this Commission's approval) to the detriment of

Georgia Company and its rate payers than likely to bring any benefit to the Georgia Company and its rate payers. The preponderance of the evidence of record is to the foregoing effect. The evidence is uncontroverted that Georgia Company has obtained and enjoys today for the benefit of its rate payers the cheapest source of 75,000 kw of electric energy available to it, and that it could not in the past, nor can it now, produce the energy at such low cost to it. The evidence is uncontroverted that Georgia Company saves about $600,000 a year by reason of the contract for the 75,000 kw. In 1956 this saving represents almost 80% of the amount of return to Generating Company found hereinabove from the estimates for that year (Table II).

3. The cost to serve the Georgia Company to the S. C. Company and its wholly owned subsidiary is found to exceed the revenues collectible under the Georgia Power contract during the first few years; but to be approximately equal to the revenues during the first half of the term of that contract, including the allowance of a 6% rate of return to Generating Company (which return is for the benefit of the parent company as the sole stockholder). Table II is illustrative of the basis of estimating; but is not determinative of the issues herein on a test year basis. If a test year basis of determination had been ordered (or permitted under the Commission's requirements regarding proof) some other year than 1956 would have been more representative, such as the year 1963. It is further found and concluded that in the last 9 or 10 years of the contract period, after depreciation has reduced the rate base substantially, the rates and charges payable by the Georgia Company may require reexamination as to whether they are higher than the then cost of service.
4. All of the electric energy generated at the Urquhart Plant has substantially the same cost to the S. C. Company, and its subsidiary. It is found, however, that the system cost of energy to AEC is somewhat higher than energy to the Georgia Company by reason of special commitments to duPont regarding protecting deliveries.

In determining whether the system cost of the energy contracted and delivered to Georgia Company and to AEC is repaid by the revenues collectible, the element of fair return is included in cost accounting under regulatory practice. But the cost as within the system (between the subsidiary—Generating Company—and its sole stockholder, the parent company, i. e., the cost of energy used by the parent, is the cost before return, as any profit paid by parent to subsidiary is returnable through dividends back to the parent that paid it. It is, therefore, concluded that the charges payable by Georgia Company under its contract (for example, $22.50 per kw plus energy charges) is not comparable with the charges payable under the contract by the S. C. Company to its subsidiary for the purpose of determining whether there is undue discrimination involved under the Federal Power Act. The system (of parent and subsidiary) is selling and incurring the cost of serving the Georgia Company in every economic reality, regardless of the separate legal entities and bookkeeping techniques. The system is not selling to itself when subsidiary generates energy and delivers it to parent. The charges ($15.30 per kw plus energy charges) paid by parent to subsidiary have any meaning only in the financing and contractual circumstances. They have no economic validity or meaning in determining the true and real cost within the system of the generation and distribution of the energy to the rate payers of the S. C. Company. It is, therefore, found and concluded that the charges payable per contract from parent to subsidiary have no validity, as a matter of fact, as a basis of comparison with contract charges to Georgia Company; and that these two contracts do not present any undue discrimination, or make or grant any undue preference or advantage or subject any person to any undue prejudice or disadvantage, or represent any unreasonable difference in rates, charges, service, facilities, or in any other respect. It is further found and concluded that, insofar as the charges of Generating Company to the parent, S. C. Company, which are within the S. C. Company system, are susceptible of any mean-

ingful comparison with the charges payable by Georgia Company, the special burdens and commitments undertaken by the parent in order to finance the subsidiary and make possible the existence of the 75,000 kw of capacity and the sale and delivery thereof to the Georgia Company, which burdens and commitments have not and cannot be reduced to a definite monetary value, nevertheless, operate to equalize the benefits between Georgia Power Company and its rate payers in the State of Georgia, and the South Carolina Electric and Gas Company and its rate payers in South Carolina; and that the mutuality and mutual benefits envisaged by the officers of both companies and, sincerely sought by them, and to which they unflinchingly testified without any contradiction or contra evidence, removes these contracts from any regulatory criticism under the Federal Power Act. The burden of showing violation has not been met. There is no evidence of any kind suggesting undue discrimination or other violation beyond pointing to the obvious difference in the figures in the contracts. As a matter of fact and law, the differences are reasonable and do not create any undue discrimination, any undue preference or advantage or subject any person to any undue prejudice or disadvantage.

5. The cost to serve AEC under the duPont contract (Exhibit 12) exceeds the revenues collectible under that contract. There is a difference in the capacity charge in the duPont (AEC) contract ($19 per kw) and in the Georgia Power contract ($22.50 per kw). The quality and assurance of delivery of electric energy is higher for AEC than for the Georgia Company. The Georgia Company pays, as hereinbefore, found and concluded, approximately the cost to serve; the duPont Company (AEC) does not pay the cost to serve incurred by the S. C. Company system. AEC is being served at below cost. The Georgia Company is not being served at below cost during the entire contract period. The evidence as to why the S. C. Company system was willing to serve AEC at such a low figure has been recited and as recited is found to be factual. However, it is found and con-

cluded that the difference in the contract charges to Georgia Company does not constitute undue discrimination under the Federal Power Act, nor make nor grant undue preference or advantage to duPont over Georgia Company or its rate payers. Even assuming that under the Federal Power Act this Commission had authority (instead of the South Carolina Public Service Commission) to require Generating Company to require AEC to pay charges commensurate with system costs to serve AEC; neither Georgia Company nor its rate payers (if or as represented by the Georgia Public Service Commission) has any legal standing under the Federal Power Act to demand that this Commission require S. C. Company system to serve Georgia Company at below the cost of service.

6. It has heretofore been found and concluded that Georgia Company will not be paying any excessive rates and charges to Generating Company during the first half of the contract period. There is no legal basis for contending that this Commission has any authority to compel the Respondent to serve Georgia Company below cost for any reason, including the fact that Respondent is serving AEC at below the level of system cost.

7. Whether the reasons for serving AEC as such rates are adequate or not is beyond the issues of this case. Whether the S. C. Company system should render such service to AEC at such rates is not within the jurisdiction of this Commission to determine. The contract in question was negotiated through agencies set up by the Federal Government; but such intrastate retail industrial sale for consumption is not subject to Federal jurisdiction. It is sufficient here to find, and it is found and concluded, that such an interstate utility customer as Georgia Company has no legal standing (nor has it asserted such a position; but rather has supported the present contract) to demand service to it below cost by a South Carolina utility. Merely because the South Carolina utility deemed it sound business to supply an agency of the United States Government within its service area at rates below the system cost of service supplies no moral or legal basis

for requiring Respondent to render service in interstate commerce to a utility in another state at the same below cost rates and charges. Whether Georgia could complain if North Carolina gained such an advantage in interstate commerce is not before us. There is no evidence that any Georgia rate payer is required to pay a single cent more by reason of the low charges to the United States Government agency, AEC. If any rate payers are affected adversely, it would be the South Carolina customers of S. C. Company, not the customers of Georgia Company. But were the recommendations accepted to reduce the charges to Georgia Company because of the lower contract charges to AEC, the South Carolina customers would be required to make up the loss to the S. C. Company system of revenues below its cost to serve, including a reasonable return. Upon this record that would constitute a subsidy to the customers of the Georgia Company at the expense of the customers of South Carolina Electric and Gas Company.

8. It is, therefore, found and concluded that the rates and charges now in force under the contract with Georgia Company are just and reasonable; that they are not unduly discriminatory, make or grant no undue preference or advantage, and subject no person to any undue prejudice or disadvantage. Therefore, the Commission has no present duty or authority to determine some other just and reasonable rate, charge or contract to be thereafter observed between Respondent and Georgia Power Company, and, hence under the Federal Power Act the investigation of Respondent's rates and charges under that Act should be terminated and the proceedings herein dismissed.

ORDER

WHEREFORE, it is ordered, subject to review by the Commission, that:

(A) The investigation of the rates and charges of Respondent, South Carolina Generating Company, be and the same hereby is terminated and that the proceeding initiated by order of the Commission herein

issued October 29, 1954 be and the same hereby is dismissed and terminated.

(B) The motions of Commission Staff Counsel filed December 21, 1955 and of Respondent's Counsel filed January 16, 1956, regarding filing supplementary briefs are granted doubly to assure protecting the public interest.

EMERY J. WOODALL
Presiding Examiner

Filed: February 29, 1956
Issued: March 1, 1956

Before Commissioners: Jerome K. Kuykendall, Chairman; Seaborn L. Digby, Frederick Stueck, William R. Connole and Arthur Kline

In the Matter of
South Carolina Generating Company } Docket No. E-6585

OPINION NO. 297

OPINION AND ORDER REVERSING INITIAL DECISION OF PRESIDING EXAMINER, DETERMINING A JUST AND REASONABLE RATE AND PRESCRIBING THE FILING OF SUPPLEMENTAL RATE SCHEDULE

(Issued October 24, 1956)

This is a rate proceeding arising under Sections 205 and 206 of the Federal Power Act involving the rate for sale of electric energy by South Carolina Generating Company to Georgia Power Company. The electric energy is produced at Generating Company's Plant Urquhart steam generating station near North Augusta, South Carolina, and sold to Georgia Power Company for resale in the State of Georgia. By order issued October 29, 1954, this Commission undertook an investigation to determine whether the contract rate between Generating Company and Georgia Power Com-

pany is unjust, unreasonable, or unduly discriminatory. After hearings held intermittently from April 5, 1955 through July 20, 1955, the Presiding Examiner issued his decision on March 1, 1956, finding the rate to be just and reasonable and not unduly discriminatory. The proceeding is now before us upon exceptions filed by the Georgia Public Service Commission and the Staff of this Commission.[1] We heard oral argument in the matter on May 10, 1956. For the reasons set forth below we find that the contract rate to Georgia Power is unjust and unreasonable, and contrary to the public interest, and hereby reverse the decision of the Presiding Examiner.[2] We further direct the filing of a supplemental rate schedule containing the just and reasonable rate for service to Georgia Power Company, giving effect to our findings and order herein and reducing the rate to Georgia Power Company by $252,186 annually.

Generating Company, a wholly-owned subsidiary of South Carolina Electric & Gas Company (E.&G.Co.), was formed for the purpose of financing the construction of Plant Urquhart steam generating station. It owns and operates the station producing electric energy for sale at wholesale to three customers—E. I. duPont de Nemours & Company (duPont), as prime contractor for the Atomic Energy Commission at Aiken, South Carolina; South Carolina Electric & Gas Company, parent of Generating Company; and Georgia Power Company. Plant Urquhart has a rated capacity of 250,000 KW, made up of two 75,000 KW generators and one 100,000 KW generator.[3] One-half of the output of the two 75,000 KW units is sold through the contract here in question to Georgia Power Company; 30,000 KW is sold to duPont for the Atomic Energy Commission installation; and the remainder is sold to E.&G.Co.

E.&G.Co., which distributes and sells electric energy within the State of South Carolina, at one time considered adding this capacity to its own system instead of setting up

[1] In addition to participation by the Generating Company and the Commission's Staff, the Georgia Public Service Commission and the South Carolina Public Service Commission intervened. The Georgia Commission actively participated in the proceedings, filing a brief and exceptions. A statement of the South Carolina Commission is part of the record.

[2] Because the decision of the Presiding Examiner is at variance with our Opinion herein on most of the major issues involved we set forth our findings and conclusions in full.

[3] The 100,000 kw generator was added to the plant in September, 1955, and has no direct bearing upon these proceedings.

a subsidiary for the purpose.[4] The record shows that during 1950, E.&G.Co. had under study the addition of new generating capacity and was investigating possible sites for location of a steam plant. At that time, it came to the attention of the management of E.&G.Co. that the Atomic Energy Commission planned to locate its Savannah River Plant in the vicinity of Aiken, South Carolina. Sensing the possibility of the addition of a major increase in demand in its market area, E.&G.Co. entered into negotiations with duPont to supply electric energy to the installations at Aiken. Early in the negotiations E.&G.Co. planned to construct the new capacity itself and made an initial offer to duPont based upon that assumption. However, the rate was rejected by duPont as being too high. To meet duPont's objections it was necessary to finance construction at a lower cost than was possible for E.&G.Co. because of the restrictions in the indentures securing the bonds. Therefore, E.&G.Co. formed a wholly-owned subsidiary, the Generating Company, to finance construction of the new capacity, using 90% debt, composed of 75% in mortgage bonds, 15% in 10-year notes and 10% equity represented by common stock taken up by E.&G.Co. The substantial reduction in the cost of financing enabled E.&G.Co., through its instrument, the Generating Company, to offer a rate acceptable to duPont.[5] The location of the duPont load determined the choice of the Plant Urquhart site, approximately 15 miles from Aiken on the Savannah River.

During this period when E.&G.Co. was planning the additional capacity, Georgia Power Company also had under consideration the construction of a steam generating station with a capacity of approximately 66,000 KW. E.&G.Co. having apprised Georgia Power Company of its plans, including the low-cost financing, Georgia Power Company entered into negotiations looking toward the purchase of

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[4] South Carolina Electric & Gas Company has two subsidiaries, South Carolina Generating Company and South Carolina Natural Gas Company. These three companies, considered together, comprise the E.&G. system to which reference is made throughout the Opinion, particularly with respect to capitalization ratios.

[5] The duPont contract was not finally executed until March 9, 1954, after operation of Plant Urquhart had begun.

a substantial block of power on a long-term basis from E.&G.Co. in lieu of building the capacity itself.

Although initially it had been anticipated that duPont might require as much as 250,000 KW, this estimate proved to be far too high, and, as we have indicated, the final contract with duPont involved only 30,000 KW. Thus, Generating Company was in a position to sell 75,000 KW for service to Georgia Power Company on a long-term basis. The negotiations culminated in the contract the terms of which are the subject of this proceeding.

The contract between Generating Company and Georgia Power was executed on November 9, 1951, and was filed with this Commission as Generating Company's FPC Rate Schedule No. 1 on September 21, 1953, to be effective October 2, 1953. The contract provides for the two-part rate consisting of an energy and a capacity charge. The energy charge, about which there is no dispute in this proceeding, is based upon fuel and maintenance costs plus minor taxes not related to income. The capacity charge, as shown by the contract, is made up of a variable basic capacity charge which was estimated at the time of execution of the contract to be $15.30 per KW, and a fixed additional figure of $7.20 per KW. Subject to adjustment in the variable "basic capacity charge" from the time the contract was executed, Georgia Power Company agreed to pay $22.50 per KW over the 25-year contract term. This charge was subject to automatic escalation in the basic capacity charge component to meet actual costs of construction and to take into account certain changes in net plant which might occur over the life of the contract. As a result the capacity charge to Georgia Power Company in 1956 was estimated on the record to be $25.31 which gives effect to an escalation of the basic capacity cost from $15.30 to $18.11.[6]

More specifically, the capacity charge is computed on the following basis:

> The plant cost, including working capital and coal stocks, was estimated at $24,400,000. Annual and fixed charges on this amount were estimated at $1,576,240,

[6] For the purposes of this proceeding we have accepted the classification of costs between the capacity and energy components as proposed by Generating Company and agreed to by the Staff.

which was designed to meet fixed charges for financing, such as interest, amortization, and 8% return on equity capital. These costs resulted in a capacity charge of $10.50 per KW based upon 150,000 KW capacity. To this $10.50 is added another cost component of $4.80 per KW, representing expenses relating to the ownership of Plant Urquhart, including the performance of all corporate, legal, administrative and general functions. The breakdown of these costs is as follows:

Federal, State and local taxes	$460,000
Administrative and general expenses	60,000
Operating, supervision and labor	200,000
Total	$720,000

In contrast to the "basic capacity charge" plus $7.20 per KW applicable to the sale to Georgia Power Company, Generating Company has contracted with its parent, E.&G.Co., for the sale of energy at a capacity charge equal only to the basic capacity charge of $15.30 per KW (escalated to $18.11 for 1956). For the sale to duPont, Generating Company charges $3.70 per KW in addition to the basic capacity charge.[7] In this regard, it is significant that although duPont pays less per KW of capacity than Georgia Power Company, it receives a superior service.

The contract with Georgia Power Company contains an important cancellation provision not provided for in either the contract with duPont or E.&G.Co. The cancellation clause provides that Generating Company may, on 12 months' written notice, reduce the KW contract demand of Georgia Power Company by 25,000 KW. Further, upon 30 months' written notice, Generating Company may reduce the KW contract demand of Georgia Power Company to any extent desired. Additionally, the power delivered to duPont is intended to be continuous, with E.&G.Co. guaranteeing to back-up Generating Company's supply to duPont in case of outages of facilities at Plant Urquhart. Georgia Power Company, however, is entitled only to one-half the output

[7] Since the escalation affected only the basic capacity charge and left the surcharges to duPont and Georgia Power Company untouched, the spread between the rates remains the same.

of the two 75,000 KW units, which could mean that Georgia Power Company would be entitled to no power in case of outages of both the units. Claimed advantages accruing to Georgia Power Company, such as delivery of energy at the high side of the step-up transformer, the record shows are likewise applicable to sales to duPont and to E.&G.Co. It was this obvious difference in treatment that first brought the matter to our attention. However, in view of our finding herein with respect to the just and reasonable rate to be charged for the service to Georgia Power Company we find it unnecessary to pass upon the question of undue discrimination argued by the Staff in its brief.

It is clear from the record that the fixed surcharge of $7.20 per KW (referred to herein as the value-of-service component) assessed against Georgia Power Company approximates one-half the difference between the basic capacity charge and the estimated cost to Georgia Power Company of supplying the same capacity from an alternative source.

In deciding the question of reasonableness of the capacity charge, it is necessary for us to resolve several important issues. The first issue is whether the rate to Georgia Power Company should be based upon cost of service on a net investment rate base or whether the rate should take into account the value of service to Georgia Power Company. If the value-of-service formula as applied to the sale of electric energy is not accepted for the purpose of testing the reasonableness of the rates to Georgia Power Company, other issues which must be resolved in determining the cost of service are (1) the use of the proper test period; (2) the allowance of a reasonable rate of return; (3) allowance for income taxes; (4) the rate of depreciation affecting cost of service and the rate base, and (5) allowances for working capital and interest during construction affecting the rate base. We shall discuss each of these issues in the above-stated order.

Value of Service versus Cost of Service

Generating Company claims that the addition of $7.20 to the basic capacity charge in the rate to Georgia Power Company represents a fair value of the service rendered. In

support of its view, Generating Company argues that the Commission is not bound to the use of any single formula in rate making and urges that the Commission add to the basic capacity "cost" the $7.20 per KW "value" to rate for sales to Georgia Power Company.

There is no doubt that this splitting the difference between "cost" to Generating Company and the estimated cost to Georgia Power Company resulted from arm's length bargaining between buyer and seller and that both buyer and seller claim to be satisfied with the contract. There is also no doubt that approval of a rate based upon recognition of these elements foreign to any cost formula would be a radical departure from established rate-making principles utilized by this Commission in the regulation of public utility rates in the electric industry where there is a clearly ascertainable cost of service.

At this juncture the position of the Georgia Public Service Commission should be noted for it proposes a variant from the usual cost method. It claims that all charges above the basic capacity charge set forth in the contract should be disallowed. It urges that we prescribe a rate to be uniform for the entire term of the contract and suggests the basic capacity charge as the proper rate for the purpose. Such a solution would avoid the necessity of returning to this Commission for adjustments in the rate in case of changed circumstances and would cover all contract costs to the same extent that they are covered by the sale of E.&G.Co. However, we do not feel that we would be justified in accepting it. The rate here involved should be calculated to cover cost on a known plant investment. Without additions to plant, the depreciation reserve will increase and net plant investment will correspondingly decrease over the life of the contract. The decrease in plant investment would, of course, call for a commensurate reduction in rates. But we have no means of measuring today the costs of any net changes in plant which may be made in the future. The solution offered by the Georgia Public Service Commission would be to allow a less than fully compensatory rate during the first portion of the contract term or life of the plant and a more than compensatory rate during the remaining life of the

plant. Based upon the evidence in this record we cannot justify the level rate proposed by the Georgia Public Service Commission. It would result in an unreasonably low rate at one time and an unreasonably high rate at another. Losses incurred because a rate is too low at one time should not be made up in excessive rates in the future. *In the Matters of Atlantic Seaboard Corporation et al.*, Docket Nos. G-1175 and G-1384, Opinion No. 225, issued April 25, 1952; *cf. Bluefield Company v. Public Service Commission*, 262 U.S. 679.

Returning to Generating Company's contention, we wish to make it expressly clear that our decision is based upon a rejection of the application of the value-of-service formula to the rate for the sale of electric energy to Georgia Power Company. Of course, we are not bound to use one formula in our determination. We have heretofore consistently found, with court approval, that the cost-of-service formula is the one best adapted in determining just and reasonable rates in this industry where all costs are known or clearly determinable.

The value-of-service approach advocated by Generating Company would result in a chaotic structure based in part upon the cost to the buyer of supplying substitute power. Such "regulation" would, in fact, be no regulation at all and would completely disregard the public interest and the ultimate consumer which the Act is designed to protect. *Cf. Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672; *Mississippi River Fuel Corp. v. Federal Power Commission*, 121 F. 2d 159 (C.A. 8, 1941).

The decision of the Supreme Court in *Natural Gas Pipeline Co. of America v. Federal Power Commission*, 120 F. 2d 825 (C.A. 7, 1941) reversed on other grounds, 315 U.S. 575, should be dispositive of Generating Company's contention. When the pipeline company urged that rates should be based upon the value of service rendered to the purchaser, the Court held that such an argument ignores "the well-established holdings, backed by reason and experience, to the effect that a fair rate of return, on a fairly established rate base, supplies the correct test of reasonableness. The value

of the service to users is neither a reasonable rate, nor supported by judicial decisions." *Supra,* at p. 633.

The mild prediction by Generating Company that it might exercise the recapture or cancellation provision in its contract unless it is permitted the higher rate only serves to emphasize the importance of our adherence to the cost-of-service test. The manifest purpose of the Act is the regulation of rates for the benefit of the ultimate consumer. Section 201 (a). *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591. If we were to approve the rate contained in the contract solely upon the basis that the two contracting utilities have struck a bargain, and that one of the parties would cancel the contract unless we did approve it, we would be remiss in our duty to protect the ultimate consumer. Such a rationale could lead only to approval of all contract rates irrespective of the public interest involved contrary to the provisions and purposes of the Federal Power Act.[8]

We may also assume that state commissions will play their part to assure that any savings will be passed on to the ultimate consumer. *Federal Power Commission* v. *Interstate Natural Gas Co.,* 336 U. S. 577. That decision is reinforced here by the positive assertion of the Georgia Public Service Commission on this record that it will require the reduction in rate to Georgia Power Company to be passed on to the customers of that utility. We therefore adhere to the cost-of-service test in this proceeding. In view of the contentions here advanced, it is necessary that we remember that in an industry like this fair value is the end product of our determination and not its starting point. *Hope Natural Gas Company* v. *Federal Power Commission,* 320 U. S. 591, 601. To achieve fair value for the electric energy sold to Georgia Power Company we must first determine the cost of service.

There was some intimation by Generating Company that the reasoning upon which the recent decisions in the *Mobile*[9]

[8] If Generating Company should exercise the cancellation provision in its contract, the filing of such a notice of cancellation would afford this Commission an opportunity to determine whether such a change will be consistent with the public interest. *Pennsylvania Water & Power Co. v. Federal Power Commission,* 343 U.S. 414, 422-424.

[9] *United Gas Pipe Line Company v. Mobile Gas Service Corporation,* 350 U.S. 332.

and *Sierra Pacific* [10] cases were decided prevents us from regulating this rate to Georgia Power Company because it is a contract rate. Careful reading of these decisions demonstrates that the contrary conclusion is required. Our investigation and findings herein are precisely the type of regulation which those cases sanction. Further, it is clear that we are required to fix a rate in the public interest, not in the interest of the selling utility alone. Under the circumstances of this case, the public interest would not permit the use of the value-of-service formula as the Generating Company would have us apply it.

The Test Period

In order to determine the just and reasonable rate on a cost-of-service basis it is necessary to use a representative period showing the cost of service. For that purpose we have adopted the calendar year 1956 as shown by the Staff's evidence and testimony. We believe that the test year 1956 accurately portrays the cost of service to Georgia Power Company at the present time and for a reasonable period in the future. It would not be feasible to attempt to use a longer test period such as the 25-year term of the contract used in part and for some purposes by Generating Company and the Presiding Examiner. Costs and conditions over a quarter of a century may change so radically that to base rates of the present day upon estimates of costs and conditions 25 years or even 10 years hence would be to enter to a realm of conjecture and destroy the purpose of a cost-of-service formula.

In prescribing the just and reasonable rate on a cost-of-service formula and using a representative test year we are mindful that our rate jurisdiction is continuing. As changing conditions affect the cost of service to Georgia Power Company we can review the rate here found just and reasonable and prescribe new rates to give effect to the changed costs.

In this regard, we find that the automatic escalation provisions in the contract providing for automatic adjustment of the basic capacity charge for changes in plant investment and expenses (except for a reduction in Federal income tax-

[10] *Federal Power Commission v. Sierra Pacific Power Company*, 350 U.S. 348.

es) are unjust and unreasonable and in contravention of the provisions of the Act and the Commission's Regulations governing the filing of changes in rates by public utilities. Section 205, 16 U.S.C. 824d; Section 35.3 of the Regulations under the Federal Power Act, 18 C.F.R. 35.3. Correspondingly, we find that the contract provision denying both Generating Company and Georgia Power Company the right to seek changes in the rate over the term of the contract is unjust and unreasonable and should be eliminated.

In an effort to substantiate its claim that, even if the value-of-service formula is rejected, the contract rate to Georgia Power Company is just and reasonable, Generating Company presented evidence of its cost of service and its rate base. The Staff did not make a field investigation but, based upon a review of the cost data Generating Company submitted, proposed adjustments both as to rate base and cost-of-service items. Having given careful consideration to the proposals of Generating Company and the suggested adjustments and the evidence of the entire record, we have calculated a total rate base and a cost of service using the 1956 test year as shown in Appendices A and B attached hereto. The net result of these adjustments will be to reduce Generating Company's rate base from $13,089,200 to $12,851,181 and to reduce the total cost of service, including rate of return, from $3,500,100 to $2,995,514. Based upon estimated revenues for 1956, these adjustments will result in a reduction in revenues from $3,247,700 to $2,995,514, or a rate reduction of $252,186 annually. Since the reduction is entirely in the capacity charge, it will reduce the capacity charge in the rate to Generating Company from $25.31 per KW to $21.948 per KW.

Rate of Return

The Generating Company contends for a 6% rate of return upon a rate base of $13,089,200. It would apply this return using hypothetical system debt-equity ratio of 50% debt, 15% preferred stock and 35% common equity. Return for the year 1956 is calculated at $785,400.

We note here that the Presiding Examiner found that the Staff presented no evidence in support of its assumed 5.5% rate of return. The Examiner based his findings upon the

fact that Staff witness did not recommend a specific rate of return although he presented ample facts upon which such a value judgment could be based. Neither we nor the parties were, however, left in doubt as to the Staff's position which it argues in its brief. Nor can any party claim surprise for all the facts were placed on the record. The evidence presented by the Staff in this proceeding is precisely the type of factual evidence which we have consistently used in formulating our judgments which have been upheld in the courts.[11] Significantly, when this same issue was presented on review of our determination in another proceeding, the Court held "We think it sufficient to point out that cost of capital studies such as the one presented to the Commission have withstood judicial review in too many cases for us to reject the one now before us as a proper criterian of rate of return." *Pennsylvania Water & Power Co.* v. *Federal Power Commission,* 193 F. 2d 230, 243 (C.A.D.C., 1951), affirmed 343,U. S. 414.

In contrast, much of the evidence of Generating Company's witness amounts to no more than his conclusions unsupported by adequate factual corroboration. It would not be reasonable to base our judgment as to the fair rate of return wholly upon such opinion evidence. Instead, we reach our judgment upon the facts of record, giving due weight to opinion evidence in the context of those facts. *Market Street Railway Co.* v. *Railroad Commission of California,* 324 U. S. 548, 560. For these reasons we find that the Presiding Examiner erred in his finding that the Staff had presented no rate-of-return evidence. This reaffirms our prior determination made upon an interlocutory motion *In the Matter of Olin Gas Transmission Company,* Docket No. G-8559, issued on April 25, 1956. We find that the record contains ample

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[11] *E.g., Illinois Commerce Commission v. Natural Gas Pipeline Co. of America,* et al., 2 F.P.C. 218, affirmed, 315 U.S. 575; *City of Cleveland v. Hope Natural Gas Company,* 3 F.P.C. 150, affirmed 320 U.S. 591; *Colorado Interstate Gas Company,* Opinion No. 235, issued August 8, 1952, rev'd on other grounds but affirming Commission on rate of return, 209 F. 2d 717 (C.A.1, 1954), rev'd and affirming Commission, 348 U.S. 492. In numerous other instances the Commission has relied upon this type evidence but the determination has not been passed upon by court review. *E.g., United Fuel Gas Company,* Opinion No. 258, issued August 27, 1953; *Michigan-Wisconsin Pipe Line Company,* Opinion No. 275, issued July 30, 1954; *El Paso Natural Gas Company,* Opinion No. 278, issued November 26, 1954.

evidence upon which to base an informed judgment as to the reasonable rate of return.

Upon this evidence we find that a rate of return of 5.55%, based upon the actual debt-equity ratio of the E. & G. Co. system of 62.8%-9.4%-27.8% instead of the 90%-10% ratio of the Generating Company, is just and reasonable.[12] This will allow for service on debt and for dividends on stock. The return compares favorably with similar public utilities with like risks. It is, we believe, ample to maintain credit and attract capital.

The record contains evidence of average interest rates on outstanding bonds of the U. S. Government, industrials, railroads, and utilities, data on the cost of issuance of bonds and stocks by electric operating utilities, earnings-price ratios and yields on common stocks of electric utilities plus detailed evidence with respect to the securities and earnings of E. & G. Co.

In determining the rate of return, Generating Company proposed the use of a hypothetical system capitalization ratio of 50% debt, 15% preferred stock and 35% common equity. In support of its contention it argued that the system credit was essential to the financing of Plant Urquhart, that the system incurred costs because of the high debt ratio of the Generating Company, and that a rate of return should be based upon a 50%-15%-35% capitalization to encourage achievement of that ratio at some future date.

The Staff also proposed the use of system capitalization ratio but advocated the use of the latest actual ratio appearing in the record—62.8% debt, 9.4% preferred stock, and 27.8% common equity. We find the use of this actual ratio to be more truly representative of the facts and to be reasonable. We note that although advantage was gained through the high-debt financing of the separate entity, it is claimed that E. & G. Co. also assumed certain burdens because of the utilization of this corporate device. Among the burdens to E. & G Co., Generating Company lists various commitments which E. & G. Co. made to Generating Company. These commitments, such as the guarantee of pay-

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[12] See Appendix C for a breakdown in the actual capital ratios of the E.&G. system.

ment of commitment fees, the agreement to make up any deficiency in insurance in event Plant Urquhart were destroyed or partially destroyed, and the obligation to the successors or assigns of the Generating Company, are the normal risks which E. & G. Co. would have assumed if it had financed and constructed Plant Urquhart itself. Also to be considered are the effect of the high-debt financing of Generating Company upon the system capitalization ratio causing E. & G. Co. to issue larger amounts of equity, and the importance of the system credit in financing Plant Urquhart. The record does not contain evidence to enable us to attribute a precise value to these factors. However, the use of the actual system capitalization ratio as proposed by the Staff instead of the ratio of Generating Company will automatically give due weight to these factors treating Generating Company, for rate-of-return purposes, as if it were not a separate entity.

We reject use of the hypothetical ratio the achievement of which is no more than a vague goal which E. & G. Co. hopes to reach in 10 to 15 years. Based upon previous financing by E. & G. Co. the record fails to support a conclusion that the goal will, in fact, be reached within the time estimated by E. & G. Co. In any event, the prediction of future capitalization ratios is not a firm foundation for prescribing rates today.

Generating Company's witness gave his opinion that return on debt should be within the range of 3.5% to 3.75%. This opinion was based upon the rates of interest the system companies obtained with allowance also for the prevailing rates of interest and the general outlook. Contrary to consistent Commission precedents, the testimony bears no direct relation to the actual cost to the system of its bond capital.[13] It is but another attempt to inject the concept of replacement cost of debt capital into rate of return when actual cost of debt, coupled with return on equity commensurate with return of other utilities similarly situated, is fair and reasonable. *Safe Harbor Water Power Corp.* v. *Federal Power Commission,* 179 F. 2d 179 (C.A. 3, 1949); *Federal*

[13] Illustrative of the witness' disregard for the actual cost concept is his objection to the Staff's inclusion of the timely refinancing of 4⅛% bonds with 3% in 1950 in its calculation of the cost of debt.

Power Commission v. *Hope Natural Gas Company*, 320 U. S. 591; *Colorado Interstate Gas Company* v. *Federal Power Commission*, 209 F. 2d. 717, (C.A. 10, 1954) *certiorari* denied, 348 U. S. 818.

We find that the present cost of outstanding debt of the system is 3.46%, and that this is the proper allowance for debt in computing the rate of return of Generating Company.[14] It is noteworthy that the stated intention of E. & G. Co. is to reduce the percentage of debt in its system capitalization ratio. Taking cognizance of this aim we may assume that future financing will be primarily through the issuance of equity. In any event, any increases in cost of debt from future financing may be taken into account in fixing rates in the future if such adjustment is warranted.

Likewise, with respect to preferred stock, we find it fair and reasonable to allow only the actual cost. The record shows the average cost to be 4.9%.[15] This allowance is comparable to the average cost of money from new preferred stock issues of electric utilities over a representative period of time. Generating Company's claim for a rate of return on preferred stock of 4.75%, which is premised upon the judgment of Generating Company's witness that preferred stock usually costs about 1% to 1.25% more than bond money, is not reasonable. As we have pointed out above, the witness assumed a cost of bond money based upon factors other than actual cost. If we were to allow only an arbitrary figure of 1% to 1.25% above bond cost for preferred stock, the allowance, starting from a faulty premise, would not be sufficient to cover the actual cost of the preferred to the system. We apply to the allowance for preferred stock the same principle as we apply to bond cost.

Generating Company contends that a rate of return on common equity capital of 10% is needed to assure success of common equity financing. This was based upon the assumption that the market anticipates earnings on equity capital of E. & G. Co. of approximately 9.5% of the net proceeds from financing. To this "barebones cost" Generating Company would add a margin of approximately 0.5%.

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[14] See Appendix D.

[15] See Appendix D.

The Staff, on the other hand, would allow 10.3% on common equity using the actual 27.8% common equity financing of E. & G. Co. system. This is apparently a partially contrived rate proposed so that the over-all rate of return would equal precisely 5.5%. The evidence does show that the earnings-price ratios of E. & G. Co. common equity for the years 1950 through 1954 averaged 7.9%.[16] To this should be added approximately 0.5% to cover financing costs. Further allowance should be made for such other factors considered by investors as the relative thinness of equity, competition from public power, and adverse weather conditions affecting a system with a relatively high percentage of hydro capacity. This margin above the cost of financing also gives appropriate weight to the present upward trend in the money market. The weight to be given to these factors is necessarily a matter of judgment. Giving effect to these factors, we arrive at an allowance of 10.5% on common equity which we find, when using system capitalization ratios, is sufficient in order to assure the maintenance of financial integrity and assure the attraction of capital on favorable terms. *Federal Power Commission* v. *Hope Natural Gas Company,* 320 U. S. 591.

Applying the rates found reasonable for debt, preferred stock, and common equity, and using the system capitalization ratio of 62.8%-9.4%-27.8%, we arrive at an allowance for over-all rate of return of 5.55%.[17] This allowance we find to be ample particularly when the sheltered position of Generating Company is considered and it is noted that Georgia Power and duPont, for all intents and purposes, guarantee payment for 75,000 KW and 30,000 KW of capacity, respectively. The result of our calculation is to reduce the allowance for return to Generating Company from $785,400,

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[16] Also, the four offerings of common stock to the public by E.&G.CO. during the same period were made at net offering-price ratios ranging between 6.37⅛% and 8.1%.

[17]

	% of Total Capital	Rate	Return
Debt	62.8	@ 3.46%	2.17%
Preferred Stock	9.4	@ 4.90%	.46%
Common Equity	27.8	@ 10.50%	2.92%
	100.0		5.55%

based upon a 6% return on a rate base of $13,089,200 to $713,241, based upon a 5.55% return on a rate base of $12,851,181. (See Appendix B.)

Allowance for Income Taxes

As an item of operating expense for the year 1956, Generating Company claims $593,900 as an allowance for Federal income taxes. In computing this amount Generating Company used interest deductions based upon an assumed capitalization of 50% debt and a depreciation rate of 3%. These assumptions would result in an income tax allowance for rate-making purposes which does not correspond to the income taxes actually paid by Generating Company. To that extent the claimed allowance is unreasonable and should be disallowed.[18]

With respect to the deduction of interest payments in computing the income tax allowance, the use of the hypothetical 50% debt proposed by Generating Company would result in a smaller interest deduction and hence a larger tax allowance than if the actual interest is used. We have previously detailed the reasons for finding that the use of the hypothetical 50% debt is unreasonable in this proceeding and pointed out that the use of system capitalization ratios instead of Generating Company's ratios in calculating the allowance for the rate of return to Generating Company gives appropriate weight to the effect of the high-debt financing of Generating Company. With regard to the income tax allowance, Generating Company uses a hypothetical system capitalization ratio instead of its own actual ratio in order to erase the effect of higher tax costs which E. & G. Co. may incur as a result of the heavy debt financing of Generating Company. This is an attempt to enjoy the benefits of the high-debt financing, *i.e.*, the construction of low cost capacity and

[18] In passing, it should be noted that Generating Company, consistent with our previously announced policy concerning the computation of the Income tax allowance, did not reflect a reduction in the tax allowance resulting from the use of accelerated amortization. *In the Matters of Panhandle Eastern Pipe Line Co.* Docket Nos. G-1116, *et al.*, Opinion No. 269, issued April 15, 1954, rev'd on other grounds, 230 F. 2d 810 (C.A.D.C., 1955); *In the Matter of: Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, Docket No. R-126, Opinion Nos. 264, issued December 4, 1953. Neither the Georgia Public Service Commission nor the Staff took exception to this procedure which is not an issue in this proceeding.

the consequent sale to duPont, while making Georgia Power Company and ultimately the consumers in Georgia assume fictitious costs. As such, the allowance proposed by Generating Company is unreasonable.

We have consistently held that the allowance for taxes should not exceed taxes paid. *E.g.*, in the Matters of *Michigan-Wisconsin Pipe Line Company*, Docket Nos. G-1678 and G-1996, Opinion No. 275, issued July 30, 1954. Accordingly, the income tax allowance in this proceeding should be based upon the actual interest deduction of the Generating Company for that is the basis upon which it will pay its taxes.

Similarly with respect to the depreciation rate used in computing the income tax allowance, Generating Company's use of 3% in computing its income tax allowance in its cost of service when it actually uses 3.25% in its tax return would result in a higher tax allowance than the amount actually paid.

We find that interest deductions based upon the actual debt of Generating Company and the depreciation rate of 3.25% in determining the income tax allowance, are just and reasonable. This adjustment will result in a reduction in Generating Company's Federal income tax allowance from $593,900 to $217,434 based upon a 5.55% rate of return as shown in Appendix A attached hereto.

Annual Charge for Depreciation

In computing its annual depreciation expense, Generating Company used a rate of 3%. This is a departure from the 2.75% rate used by E. & G. Co. for many years and represents a switch in its own position during the pendency of these proceedings. While, of course, the change in position might be acceptable if fully justified, Generating Company did not present convincing evidence in support of its newly taken position. Demonstrably, the shift from 2.75% to 3% involves the assumption that the average service life of all plant and equipment abruptly dropped from 36.36 years to 33.33 years. One reason given was that proximity to the Atomic Energy Commission installation at Aiken increased "the hazards of infant mortality." Such a conclusion was not based on any specific study showing a decrease in serv-

ice life but was based upon a "fear of the unknown." However real that fear might be, it is not proper to reflect it in depreciation. *Uniform System of Accounts Prescribed for Public Utilities and Licensees, Definition No. 13.* Investors are compensated for such remote contingencies in the cost of capital and the rate of return.

Due weight should be given to obsolescence and changes in the art. But aside from unsupported opinion testimony, the Generating Company presented no evidence why such factors should increase the depreciation rate here. Significantly, the electric utility industry, which does allow for obsolescence and changes in the art in depreciation rates, has not changed its depreciation rates as Generating Company would do here apparently for the purposes of this proceeding.

We find that the use of a rate of 2.75% in computing the annual charge for depreciation is just and reasonable. This adjustment results in an allowance for depreciation of $372,985 based upon the 1956 test year instead of $407,800 proposed by Generating Company. (See Appendix A.)

Depreciation Reserve

The use of the 2.75% depreciation rate, of course, applies to the computation of the depreciation reserve. The average depreciation reserve, using 2.75% instead of 3%, is reduced from Generating Company's figure of $1,002,000 to $916,420 and the net plant is correspondingly increased by $85,580. (See Appendix B.)

Interest During Construction

Staff proposes to reduce Generating Company's average plant account by $30,269 from $13,704,600 to $13,674,331 to give effect to an allowance of interest on equity funds during construction of 6% per year instead of 8% as proposed by Generating Company. We find that such an adjustment is reasonable and proper and in accord with Electric Plant Instruction No. 5 (paragraph 17) of the *Uniform System of Accounts Prescribed for Public Utilities and Licensees.* Instruction No. 5 provides that, as a component of construction cost properly includible in electric plant accounts, there shall be an allowance for interest during construction including "the net cost of borrowed funds used for construc-

tion purposes and a reasonable rate upon the utility's own funds when so used." E. & G. Co.'s equity funds used for construction purposes should be allowed a reasonable rate. This does not mean that Generating Company should be permitted to capitalize profits on investment before commercial operation of the plant has begun. We find 6% on equity funds used for construction purposes to be reasonable and consistent with our past practice. *E.g., In the Matters of Michigan-Wisconsin Pipe Line Company,* Docket Nos. G-1678 and G-1996, Opinion No. 275, issued July 30, 1954; *In the Matters of Northern Natural Gas Company,* Docket Nos. G-1382, G-1533 and G-1607, Opinion No. 228, issued June 11, 1952, affirmed 206 F. 2d 690 (C.A. 8, 1953).

Working Capital

Generating Company computed working capital for the year 1956 at $386,600, which consists of $195,400 for materials and supplies plus $191,200 representing 12.5% of its annual operating expenses. The Staff adjustment would reduce the total figure by $293,300 to $93,270. This reduction is the result of two corrections. The first would reduce the allowance for operating expenses from $191,200 to $45,725 to eliminate the allowance for the purchase of natural gas. Since Generating Company receives payment from Georgia Power Company before it must pay for natural gas delivered to it for use as fuel at Plant Urquhart, working capital is not needed to cover this operating expense.

The second correction would reduce working capital by $147,855 for Federal income taxes which Generating Company receives in revenues in advance of payment to the Federal Government. The credit amounts to 68% of the allowance for Federal income taxes which is the average amount available to the Generating Company during the test year.

We find both of these adjustments to working capital to be reasonable. Certainly the working capital allowance for rate purposes should not include as operating expenses an amount not needed for that purpose. And, with respect to income tax accruals, we have consistently held that when funds for working capital are supplied by ratepayers and result from the annual lag in income tax payments, the util-

ity has available to it funds which offset capital requirements otherwise to be supplied by investors. To the extent income tax accruals are available from payments by Georgia Power Company, it is inequitable to require it to pay a return upon working capital. *Alabama-Tennessee Natural Gas Company* v. *Federal Power Commission,* 203 F. 2d 494 (C.A. 3, 1953) *Northern Natural Gas Company* v. *Federal Power Commission,* 206 F. 2d 690 (C.A. 8), *certiorari* denied, 346 U. S. 922.

The Commission further *finds*:

(1) South Carolina Generating Company is a wholly-owned sudsidiary of South Carolina Electric & Gas Company (E. & G. Co.) which distributes and sells electric energy wholly within the State of South Carolina. E. & G. Co. also owns all the capital stock of South Carolina Natural Gas Company. For the purposes of this proceeding the two subsidiaries and the parent company, considered together, are termed the Electric & Gas system.

(2) Generating Company owns and operates a steam generating station, known as Plant Urquhart, on the Savannah River, near Beech Island and North Augusta, South Carolina.

(3) Plant Urquhart was originally constructed with two 75,000 KW generating units which were placed in operation in December, 1953 and February, 1954, respectively. A third unit of 100,000 KW was planned to be placed in service in September, 1955 and a fourth unit of 125,000 KW in 1958.

(4) By contract dated November 9, 1951, and on file with this Commission as Generating Company's Rate Schedule FPC No. 1, one-half the capacity of the first two 75,000 KW units at Plant Urquhart is sold to the Georgia Power Company for a contract term of 25 years.

(5) 30,000 KW of capacity from the first two 75,000 KW units is sold to E. I. duPont de Nemours & Company (duPont) for use at the installation of the Atomic Energy Commission at Aiken, South Carolina. The remaining 45,000 KW of capacity from the first two 75,000 KW units is sold to E. & G. Co.

(6) Energy sold to Georgia Power Company is transmitted by Generating Company at 115 kv for a distance of approximately one-half a mile from Plant Urquhart to the Georgia-South Carolina state boundary, where it is delivered to Georgia Power Company which distributes and sells the energy for consumption in Georgia.

(7) The facilities used for the transmission and sale of electric energy to Georgia Power Company, as set forth in paragraph (6) herein, are in addition to and do not include facilities used for the generation of electric energy, facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or facilities for the transmission of electric energy consumed wholly by the transmitter.

(8) The sale of electric energy by Generating Company to Georgia Power Company is a sale of electric energy at wholesale in interstate commerce within the meaning of Sections 201, 205 and 206 of the Federal Power Act.

(9) By reason of ownership and operation of facilities for the transmission and sale of electric energy to Georgia Power Company for resale as set forth in finding (6) herein, Generating Company is a "public utility" within the meaning of Part II of the Federal Power Act.

(10) Pursuant to the terms of the contract between Generating Company and Georgia Power Company electric energy is sold to Georgia Power Company under a two-part rate composed of an energy charge and a capacity charge. The capacity charge is made up of a "basic capacity charge" of $15.30 per KW, adjusted to $18.11 per KW for 1956, and an additional charge of $7.20 per KW. The energy charge is designed to recover fuel, maintenance and minor tax costs.

(11) The $7.20 per KW component in the capacity charge contained in the contract between Generating Company and Georgia Power Company is not related to the cost to Generating Company of rendering the

service but represents a value-of-service component approximately equal to one-half the difference between the "basic capacity charge" of $15.30, as set forth in the contract, and the estimated cost to Georgia Power Company of providing the same capacity itself.

(12) The use of the value-of-service component in the rate to Georgia Power Company is unjust and unreasonable and contrary to the public interest.

(13) Based upon a reasonable test period, the just and reasonable rate to Georgia Power Company should provide revenues sufficient to recover the cost of the service, including a fair return upon the amount prudently invested.

(14) The calendar year 1956 can reasonably be expected to be representative of the immediate future and is suitable for use as a test period in determining the cost of service to Georgia Power Company.

(15) In determining the over-all rate of return of Generating Company allowance of the actual cost to the system of its debt capital of 3.46% and of its preferred stock capital of 4.90% is fair and reasonable.

(16) An allowance of 10.5% for common equity capital of the system provides a sufficient margin in excess of the cost to the system of its common equity capital to assure maintenance of the system's financial integrity and its ability to attract capital on the most favorable terms, and is fair and reasonable.

(17) The over-all cost of capital to the system is properly determined by applying the fair and reasonable rates for debt, preferred stock, and common equity to the actual ratios of the system of 62.8% for debt capital, 9.4% for preferred stock capital, and 27.8% for common equity capital as of December 31, 1954. This application results in an over-all cost of 5.55%.

(18) Based upon the system cost of capital as found above, the allowance of a rate of return of 5.55% to Generating Company is fair and reasonable.

(19) In determining Federal income tax expense, actual interest paid by Generating Company on the basis of

its actual capitalization, and the depreciation rate of 3.25% used by Generating Company in computing its actual income tax should be used.

(20) In determining the annual charge for depreciation in the cost of service, use of the rate of 2.75% instead of the 3% contended for by Generating Company is fair and reasonable.

(21) The amount claimed by Generating Company for net plant should be modified to reflect the use of the 2.75% rate of depreciation found fair and reasonable in (20) above, and by computing interest during construction on equity funds at 6% instead of 8%.

(22) Generating Company's claimed allowance for working capital should be reduced by eliminating expenditures for natural gas from total operating expenses for which cash working capital must be provided, and by crediting working capital with that portion of the cash accrued from income tax receipts for sale of electric energy to Georgia Power Company which is available for use of Generating Company between the dates of receipt and the dates of payment of the tax, amounting to 68% of the allowance for Federal income tax expense.

(23) The annual cost of service to Georgia Power Company, including an allowance for return of 5.55% as found in paragraph (18) determined in accordance with the findings in paragraph (15) through (22) herein, using 1956 as the test year, is $2,995,514. The costs classified to capacity are $1,646,114, or $21,948 per KW.

(24) The present rate to Georgia Power Company based upon the contract between Generating Company and Georgia Power Company would produce revenues of $3,247,700, or $252,186 in excess of the cost of service. Under the classification procedures which we have accepted for the purposes of this proceeding, the excess, amounting to $3.36 per KW, is entirely in the capacity component of the rate.

(25) The capacity component in the present rate for service to Georgia Power Company is in excess of a just and reasonable rate and is unjust and unreasonable.

(26) A rate which will provide revenues equal to the cost of service of $2,995,514, with a capacity component of $21.948 per KW producing revenues equal to the cost of providing the capacity, is just and reasonable.

(27) It is necessary and appropriate to carry out the provisions of the Federal Power Act that Generating Company be required to file changes to its Rate Schedule No. 1 so as to put into effect a capacity rate component of $21.948 per KW without provision for adjustment with respect to changes in plant investment and expenses, but with provision for a reduction therein in the event the Federal income tax rate is lowered, and with a provision allowing either Generating Company or Georgia Power Company to initiate a change in rate in accordance with the provisions of the Act.

Within 30 days of the issuance of this opinion and order Generating Company shall file a supplement to its Rate Schedule FPC No. 1 for service to Georgia Power Company so as to effect the following changes:

(1) The substitution of $21.948 per KW for the present capacity component of the rate and the elimination of all provisions for adjustment thereof, including Sections 3.02 (b), (c), (d) and (e), except that the new capacity component shall be adjusted to reflect any increase or decrease in the Federal Income tax rate upon filing of proper notice of the change pursuant to the Regulations under the Federal Power Act.

(2) The amendment of Section 7.06 so as to permit either Generating Company or Georgia Power Company to initiate a change in the rate in accordance with the provisions of the Federal Power Act.

By the Commission. Commissioner Digby dissenting.

s/ Leon M. Fuquay
Leon M. Fuquay, *Secretary.*

APPENDIX A

Cost of Serviec
Year 1956

Particulars	*Total*	*Cost Classification* *Energy Costs*	*Capacity Costs*
Operation and Maintenance			
Fuel	$1,309,000	$1,309,000	$
Maintenance	33,400	32,900	500
Other	187,200		187,200
Total Operation and Maintenance	$1,529,600	$1,341,900	$ 187,700
Depreciation	$ 372,985	$	$ 372,985
Taxes—Other than Income	119,500	7,500	112,000
Income Taxes:			
Federal	217,434		217,434
State	43,854		43,854
Return at 5.55%	713,241		713,241
Credit for Rents	(1,100)		(1,100)
Total Cost of Service	$2,995,514	$1,349,400	$1,646,114
KWH (000)		466,500	
Energy Cost per KWH		$ .0028926	
Contract Demand—KW			75,000
Cost per KW of Contract Demand			$ 21.948

APPENDIX B

Rate Base and Return
Year 1956

Particulars	*Amount*
Plant:	
Gross Average Investment	$13,674,331
Less: Average Depreciation Reserve	916,420
Average Net Plant Investment	$12,757,911
Working Capital Requirement:	
Material and Supplies	195,400
Cash for expenses	45,725
Credit for tax accrual funds	(147,855)
Net Working Capital Requirement	93,270
Total Rate Base	$12,851,181
Return at 5.55%	$ 713,241

APPENDIX C
SOUTH CAROLINA ELECTRIC & GAS CO. AND SUBSIDIARIES
CAPITALIZATION

December 31, 1954

Issue	*Amount*	*Amount*	*Percent*
Long-Term Debt:			
South Carolina Electric & Gas Co.:			
First and Refunding Mortgage Bonds:			
3% Series, 1980	$ 22,200,000		
3% Series A, 1980	4,000,000		
3¾% Series, 1981	6,000,000		
4⅛% Series, 1983	4,000,000		
3% Series, 1975 (South Carolina Power Co.)	8,000,000		
3% Series, 1977 (South Carolina Power Co.)	4,000,000		
3⅛% Series, 1979 (South Carolina Power Co.)	4,000,000		
Gold Bonds, 5%, 1999 (Charleston Consolidated Railway, Gas and Electric Company)	1,557,000		
Bank Notes, 2½% to 1958	1,762,500		
South Carolina Generating Company:			
First Mtge. Bonds, 3⅞%, 1979	19,878,000		
First Mtge. Bonds, 4%, 1981	4,200,000		
Promissory Notes, 4%, 1964	3,496,000		
South Carolina Natural Gas Co.:			
First Mtge. P. L. Bonds, 3⅞%, 1973	4,000,000		
Total Long-Term Debt		$ 87,093,500	62.8%
Preferred Stock:			
4.50%, $50 par	4,000,000		
4.60%, $50 par	2,765,000		
5%, $50 par	6,261,700		
Total Preferred Stock		13,026,700	9.4%
Common Equity:			
Common Stock, 4.50 par	14,178,577		
Premium on Common	9,539,946		
Earned Surplus	7,245,502		
Capital Surplus	7,527,858		
Total Common Equity		38,491,883	27.8%
Total Capitalization		$138,612,083	100.0%

Source of Data: Prospectus dated 2/24/55 covering 210,053 shares of common stock

APPENDIX D (Revised 5/23/55)

SOUTH CAROLINA ELECTRIC & GAS CO. AND SUBSIDIARIES
COST OF OUTSTANDING DEBT AND PREFERRED STOCK

Issue	Date of Issue	Amount of Issue (000)	Out-standing 12/31/54 (000)	Price to Purchaser (000)	Net Proceeds to Company		Net Cost to Company
					Total (000)	Per Unit	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
Long-Term Debt							
S. C. Electric & Gas Co.							
1st and Ref. Mtge. Bonds:							
3% Series, 1980[4]	4- 1-50	$22,200	$22,200	$22,866	$22,575	101.69	2.91%
3% Series A, 1980	12- 1-50	4,000	4,000	4,040	4,009	100.22	2.99
3¼% Series, 1981	7- 1-51	6,000	6,000	6,000	5,947	99.12	3.80
4⅛% Series, 1983	12-17-53	4,000	4,000	4,000	3,982	99.56	4.15
3% Series, 1975 (S. C. Power Co.)[4]	1-26-45	8,000	8,000	8,110	7,993	99.92	3.00
3% Series, 1977 (S. C. Power Co.)[4]	5- 1-47	4,000	4,000	4,120	4,054	101.35	2.93
3⅛% Series, 1979 (S. C. Power Co.)	7- 1-49	4,000	4,000	4,000	3,941	98.53	3.20
Gold Bonds, 5%, 1999 (Charleston Consolidated Ry. Gas & Elec. Co.)	3-1-1899	2,500	1,557				5.07[1]
Bank Notes, 2½% to 1958	5-28-48	6,200	1,762	6,200	6,118	98.69	2.76
S. C. Generating Co.:							
First Mtge. Bonds, 3⅞%, 1979	1952-1954	20,000	19,878	20,000	19,836	99.18	3.93
First Mtge. Bonds, 4%, 1981	1954	4,200	4,200	4,200	4,086	97.29	4.17
Promissory Notes, 4%, 1964	1952-1953	4,000	3,496	4,000	3,966	99.14	4.10
S. C. Natural Gas Co.:							
1st Mtge. P. L. Bonds, 3⅞%, 1973	1954	4,000	4,000	4,200	4,155	103.89	3.59[5]
Total Long-Term Debt			$87,093				3.46%
Preferred Stock							
4.50%, $50 par	1954	4,000	4,000	4,000	3,902	48.78	4.61
4.60%, $50 par	10- 3-50	3,000	2,765	3,000	2,907	48.44	4.75
5%, $50 par	1943[2]	6,262	6,262	6,262	[2]	[2]	5.15[3]
Total Preferred Stock			$13,027				4.90%

[1]In the absence of data .07 was added to coupon rate based on cost of other issues.
[2]Issued 1943 in exchange for Pfd. Stock, Bonds and debs.
[3]Expense estimated at .15% based on cost of other issues. This 5% series at end of April 1955 was selling at 53 to yield 4.7%. (Standard & Poor's Stock Guide, May 1955).
[4] 3% Bonds due 1975, 1977 and 1980, which are publicly held, were quoted in April 1955 at 94 to yield 3.21% to maturity. (Standard & Poor's Guide, May 1955).
[5]Disregards $313,443 call premium and expense of refunding $4,000,000 and redeeming $500,000 of 4¾% bonds before consideration of related estimated Federal income tax reduction of $168,000.
Source: Prospectus 2-24-55, Form No. 1, S. E. C. Publications, data furnished by Company.

In the Matter of
South Carolina Generating Company
Docket No. E-6585

PETITION FOR REHEARING

Now comes the South Carolina Generating Company to respectfully petition the Commission to grant a rehearing of the issues presented in this cause and decided by the Commission's Opinion No. 297 of October 24, 1956, for the reasons set out herein.

I.

Under the order of the Commission of October 29, 1954 initiating these proceedings the South Carolina Generating Company was required to show its cost of rendering the service to the Georgia Power Company under the contract in issue here for the year 1954 and for every fifth year thereafter during the twenty-five (25) year life of the contract. This was done and the hearings proceeded on the basis of an investigation of whether the entire contract was unjust or unreasonable. Thus the scope of the hearing as established by the initiating order encompassed the contract in its entirety. The Presiding Examiner made his findings that the rates and charges in the Georgia contract were just, reasonable and non-discriminatory on the basis of the contract, not merely on the basis of the particular year 1956.

The Commission in refusing to follow the Examiner's Report and the Order initiating the investigation failed to consider the entire contract by confining its findings to the Calendar year 1956.

II.

The Commission's Order overrules the decision of the Presiding Examiner on every material issue in the investigation. The findings of the Examiner are amply supported by the evidence of record. Since the Examiner heard all of the witnesses testify, had the benefit of full briefs by all parties and the members of the Commission had no opportunity to hear the witnesses, and only a minority of those deciding this matter the opportunity of hearing oral argument, sound administrative procedure requires that the Commission accept the findings of the Examiner.

III.

Since there is no substantial evidence that the rates and charges to the Georgia Power Company under the contract in issue here are unjust or unreasonable and since the Commission Staff and the Georgia Commission have failed to sustain the burden of proof that these rates and charges were unjust or unreasonable within the meaning of §206, the Commission should have confirmed the Examiner's conclusion that these rates were neither unjust nor unreasonable. *Colorado Interstate Gas Co. vs. Federal Power Comm.* 142 F. 2d. 943, 954.

IV.

The contract of November 9, 1951 between the Generating Company and the Georgia Power Company, under which the former sold and the latter bought 75,000 kw of electrical energy over a twenty-five (25) year period under the terms and conditions contained therein, was an agreement between two unaffiliated electric utilities bargaining at arms length which resulted in mutual benefits to each. By the undisputed testimony in this hearing it permitted the Georgia Power Company to obtain 75,000 kw at a cost of $600,000.00 less per year than it could have obtained such energy from any other source, thus benefiting its customers in Georgia. The terms and conditions of this contract are not subject to modification by this Commission under the doctrine of *Federal Power Commission vs. Sierra Pacific Power Company,* 350 U. S. 348, because there is no showing that the rates and charges under this contract to the Georgia Power Company are so high as to impair "the financial ability" of Georgia "to continue its service, cast upon other consumers an excessive burden or be unduly discriminatory", or otherwise adversely affect the public interest.

V.

The Commission's decision strikes down a fairly negotiated and still mutually satisfactory contract between neighboring electrical utilities providing for joint participation in building and operating additional generating facilities at substantial economies to both utilities, and therefore to the customers of each. The order constitutes a precedent which

will deprive consumers of the benefits of economical cooperation between utilities and which will render more difficult the building of badly needed generating facilities throughout the nation in violation of the spirit of the Federal Power Act.

VI.

In the face of inflationary tendencies over recent decades utility rates have been maintained with no appreciable increase by the increase in plant efficiency, particularly in generating facilities. One of the important factors in the reduction in production costs has been the trend to large and multiple generating units. In turn this increases the advantages of power interchanges between neighboring utilities to effect mass production economies and the maximum utilization of capacity reserves. These economies and these interchanges have been encouraged and are being encouraged by this Commission.

The effect of the order issued here will be to discourage the joint use of facilities. Management cannot be expected to enter into such arrangements if arrangements carefully hammered out on the anvil of arms length negotiations are stricken down though manifestly advantageous to both parties. Investors will hesitate to finance such arrangements as this, and if they do will require higher money costs for arrangements because of the uncertainty of Commission approval, and management knowing that it can recover its entire cost on a cost-to-serve formula will lose much of its incentive to work out joint use of generating facilities with other utilities. The result will be an ultimate increase of the cost to the ultimate consumer and therefore not in the public interest.

VII.

The record shows that under the contract charges the Georgia consumers are substantially benefited. Nevertheless the Commission (p. 8) gives weight to the view that the reduction in annual charges to the Georgia Power Company of some $252,000.00 will be passed on to the consumers of that Company under representations made by the Georgia Public Service Commission, even though no rate proceeding is pending before the Georgia Commission. Such a consideration

is inappropriate in this cause. Respondent can obtain revenues only from Georgia Power Company and Electric & Gas. If the revenues from Georgia Power Company are to be eliminated or substantially reduced, it necessarily follows that an equivalent additional amount will have to be collected by the South Carolina Electric & Gas system from its consumers in South Carolina. There is no showing in this case that an additional rate burden on the South Carolina consumers in order to benefit the consumers in Georgia is justifiable.[1]

VIII.

In its Order the Commission recognizes that it is not bound to follow a "cost to serve" formula. In this case the record conclusively establishes that the contract is a benefit to each utility and to the customers of each. In such circumstances the public interest is not served by an exercise of the power to change the charges. *Arkansas Natural Gas vs. Arkansas Railroad Commission,* 261 U. S. 379, 383.

IX.

The parent company is essentially the vendor to Georgia, negotiating for the sale before Generating Company was incorporated, and shortly thereafter, following assurances from Georgia, firming in the parent's name, the manufacturer's commitment for the second unit at Urquhart Station. The special financing involving a separate indenture and high debt with rapid pay-off, proposed for serving duPont became a practical necessity for prompt financing of a second unit. In order for Generating Company to obtain this necessary debt financing the parent was required to make many significant commitments and guarantees to the security holders and to the Generating Company which included the guarantee of commitment fees, providing excess funds to complete the station, the limited guarantee of the principal and interest on the bonds, the furnishings of funds in excess of insurance to rebuild, to take over any excess capacity, to back

[1] The Georgia Power Company has total assets of approximately $408,000,000, annual operating revenues of $100,000,000, and 560,000 customers. The South Carolina Electric & Gas system has total assets of approximately $170,000,000, annual operating revenues of $41,800,000 and 160,000 customers.

up the duPont contract, and to supplement its payments for power in the event of low revenues. Therefore, these obligations of the parent, although not reflected on the books of Generating Company, should have been considered in determining the cost to serve, but they are not given appropriate consideration in the Commission's order.

X.

The record conclusively shows that because of this 90% debt capitalization of the Generating Company the parent company, during the years of the Urquhart construction (1951-1954), was required to do its own financing for expansion on a high equity ratio, raising during these years 72% of its increase in capital from common equity financing. Because equity money costs much more than debt money (the Commission determines the relative costs at 10.5% for equity and 3.46% for debt, p. 13) and because Federal income taxes are calculated on the income after *interest* on debt but before *dividend* on stock, this displacement of the capital structure of the parent must be considered on the issue of whether the contract rates are reasonable. The Urquhart plant was and could only have been financed on the credit of the parent. The Electric & Gas system is a single economic unit and the impact of the Georgia contract on the system must be considered. The record here permits no other treatment. While the order of the Commission uses the *system* capitalization to determine an appropriate rate of return on the *Generating Company's* properties used to serve this contract, it refuses to adjust the interest deduction of Generating Company and the resulting low Federal income taxes to accord with this system ratio.

XI.

The evidence in this case shows that on a cost to serve basis a rate of return of 6% on the investment in the properties used to serve the Georgia contract is not unjust or unreasonable. This rate of return was supported by the testimony of one of the partners in Kidder, Peabody & Company, one of the largest dealers in electric utility securities, and by the testimony of the financial Vice President of the South Caro-

lina Electric & Gas Company. It is less than the national average return of 6.2% for Class A and B electric utilities as published by the Commission. There is no testimony in the record that such a return is unreasonable or unjust, or that any lower rate of return is reasonable or just. In fact, the evidence shows that the South Carolina Electric & Gas System is a small utility with heavy public power competition, losing bus operations and a high dependence on hydro generation, factors which make a rate above 6% reasonable and just.

XII.

The order of the Commission fails to take into consideration the increase in money costs which have occurred in 1955 and 1956 in the fifteen months period between the date of the closing of testimony in July, 1955 and the date of the order, October, 1956. This increase in money cost is substantial, is available to the Commission from financial publications, and since rates are being made for the future merited consideration. The increase is shown in Exhibit "A" attached hereto, which is a Staff Exhibit 18 brought up to date.

XIII.

The evidence supports the use of a 3% straight line depreciation rate both for tax and expense purposes and the Commission should have approved the use of this rate rather than the use of 2.75% rate for expense and a 3.25% rate for tax purposes, which are not supported by any evidence of probative value.

XIV.

The record shows that the money advanced by the parent to the Generating Company during construction came entirely from equity sources. Since the order provides that a fair return on equity capital is 10.5%, interest during construction should be computed on the basis of at least 8%, as recommended by the Examiner.

XV.

In its order the Commission has computed the South Carolina income tax at a 4.5% rate, whereas the rate is now 5%,

which became effective, as the Commission was advised in the record of the parties, under the provisions of the 1955 Acts (p. 329) as to income tax accounting periods after June 30, 1956. 1952 Code 65-222.

XVI.

In applying the capitalization ratios of the Electric & Gas system for the test year 1956, the Commission used the ratios of December 31, 1954 rather than the later ratios available in the record, as this computation shows:

	Used by FPC (12-31-54)	*Projected* (12-31-55	12-31-56)	*Actual* (12-31-55	9-30-56)
Debt	62.8	62.06	59.51	62.17	58.53
Preferred	9.4	8.47	10.02	8.46	11.31
Common	27.8	29.47	30.47	29.37	30.16

If the reasonableness of the rates and charges are to be determined on the test year 1956, then the capitalization should be computed on the basis of 1956 percentages.

XVII.

The provisions in the contract for automatic adjustment in plant investment and expenses are not unjust or unreasonable and are not in contravention of §205 of the Federal Power Act (16 USCA 824d) or of any valid regulation thereunder. While the order would declare this type of escalation invalid, it recognizes escalation clauses with reference to fuel, maintenance and related taxes. Cf. *in the Matter of: American Louisiana Pipe Line Company,* Docket G-2306 (Order July 20, 1956). Since there is always a "regulatory lag", escalation clauses are important to preserve returns at the proper level. To strike these down means that an additional burden of regulation will be thrown unnecessarily on the staff of this Commission and correspondingly increased operating expenses on the Electric & Gas system incident to the necessity of frequently applying to the Commission for adjustments due to cost changes.

XVIII.

The effect of the order of the Commission is to set aside rates and charges which are neither unjust nor unreasonable

and to establish rates and charges which are neither just nor reasonable, as Exhibit "B" shows.

XIX.

The Commission should have found, as did the Examiner:

8. It is, therefore, found and concluded that the rates and charges now in force under the contract with Georgia Company are just and reasonable; that they are not unduly discriminatory, make or grant no undue preference or advantage, and subject no person to any undue prejudice or disadvantage. Therefore, the Commission has no present duty or authority to determine some other just and reasonable rate, charge or contract to be thereafter observed between Respondent and Georgia Power Company, and, hence under the Federal Power Act the investigation of Respondent's rates and charges under that Act should be terminated and the proceedings herein dismissed.

XX.

For the reasons given by the Presiding Examiner, the direct examination of the witness Knowles Davis should not have been received into evidence or given consideration by the Commission.

All of which is respectfully submitted.

(Sgd.) W. C. McLain

.....

W. C. McLain

(Sgd.) D. W.Robinson

.....

D. W. Robinson

(Sgd.) Arthur M. Williams, Jr.

.....

Arthur M. Williams, Jr.
Counsel for Respondent, South Carolina Generating Company

Columbia, S. C.
November 21, 1956

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

In the Matter of
South Carolina Generating Company } Docket No. E-6585

EXHIBIT 18 — BROUGHT UP TO DATE

	1955		1956									
	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.
(1b) U. S. Treasury Bonds	2.89	2.88	2.83	2.81	2.93	3.07	2.93	2.94	3.20	3.42	3.43	3.33
(2a) 40 Industrials	3.24	3.28	3.22	3.19	3.27	3.41	3.40	3.39	3.42	3.55	3.68	3.75
(2b) 40 Railroads	3.39	3.45	3.39	3.37	3.37	3.53	3.53	3.56	3.59	3.72	3.83	3.91
(3a) 10 Public Utilities (AAA)	3.15	3.19	3.13	3.09	3.13	3.31	3.30	3.29	3.30	3.44	3.58	3.63
(3b) 10 Public Utilities (AA)	3.20	3.25	3.16	3.12	3.18	3.37	3.34	3.34	3.37	3.48	3.61	3.69
(3c) 10 Public Utilities (A)	3.33	3.36	3.30	3.28	3.28	3.49	3.48	3.49	3.55	3.63	3.72	3.81
(3d) 10 Public Utilities (BAA)	3.49	3.51	3.50	3.50	3.52	3.64	3.62	3.65	3.70	3.84	4.02	4.16

Exhibit B

SOUTH CAROLINA GENERATING COMPANY

Demonstration of Inadequate FPC Allowance for Income Taxes

	FPC Order	FPC, with Income Tax Correction	Revision with Proper Tax Components	Necessary Changes (Col. 3—Col. 1)
Revenues:				
Georgia Power Co.	$2,995,514	$2,995,514	$3,184,924	$ 189,410
Rent Income	1,100	1,100	1,100	
Total Revenues	$2,996,614	$2,996,614	$3,186,024	
Revenue Deductions:				
Operation & Maintenance	$1,529,600	$1,529,600	$1,529,600	
Depreciation	372,985	372,985	372,985	
Taxes—Other than Income	119,500	119,500	119,500	
	$2,022,085	$2,022,085	$2,022,085	
Balance before Inc. Taxes	$ 974,529	$ 974,529	$1,163,939	
State Income Tax @ 4.5%	43,854	43,854	52,377	8,523
Balance before Fed. Inc. Tax	$ 930,675	$ 930,675	$1,111,562	
Federal Income Tax (A)	217,434	303,941	398,002	180,568
Operating Income	$ 713,241	$ 626,734	$ 713,560	
Return per FPC Formula (B)	713,241	713,560	713,560	319
Difference	-0-	$ 86,826	-0-	
(A) Federal Income Tax:				
Bal. before Fed. Inc. Tax	$ 930,675	$ 930,675	$1,111,562	
½% Depreciation Adjustment	66,933	66,933	66,933	
	$ 863,742	$ 863,742	$1,044,629	
Interest Deduction (B)	445,600	279,241	279,241	
Taxable Income	$ 418,142	$ 584,501	$ 765,388	
Federal Inc. Tax @ 52%	217,434	303,941	398,002	
(B) Components of Rate Base:	Ratio	Amount	Rate	Cost
Debt	62.8%	$ 8,070,542	3.46%	$ 279,241
Preferred	9.4%	1,208,011	4.90%	59,193
Common	27.8%	3,572,628	10.50%	375,126
Total	100.0%	$ 12,851,181		
Return per FPC Formula			5.55%	$ 713,560

NOTE

This statement is solely intended to demonstrate the inadequacy of the FPC allowance for income taxes to produce their indicated return on their rate base determination. The use of these basic figures should not be construed as an admission of the adequacy of a 5.55% return or the propriety of their depreciation adjustment in computing Federal income taxes (under existing circumstances) or the 4.5% state income tax rate instead of the actual present 5% rate. For simplification, a further adjustment of the rate base, to reflect changes in the income tax credit in the working fund component, has been ignored.

In the Matter of
South Carolina Generating Company
Docket No. E-6585

PETITION FOR REHEARING

Now comes the South Carolina Public Service Commission, a party in the above captioned proceeding, and respectfully prays the Federal Power Commission to grant a rehearing of the issues presented in this case and decided by that Commission's Opinion and Order issued on the 24th day of October, 1956 and numbered 297, all for the reasons hereinafter set forth.

I

That the Federal Power Commission's Staff has failed to sustain the burden of proof that the rates and charges under consideration are or were unjust or unreasonable within the meaning of §206 of the Federal Power Act, and that there is no substantial evidence in the record that the rates and charges in the contract here in issue were or are unjust or unreasonable within the meaning of the said §206 or in any other manner.

II

That the contract involved in this proceeding was arrived at by arms length bargaining and resulted in an agreement more beneficial to both companies and, through them, more beneficial to their respective consumers, than the contract exists as modified by the Federal Power Commission's Opinion No. 297 as aforesaid, and that such modification is not in the public interest, but is directly opposed thereto in that the contract as changed by the Federal Power Commission's said Opinion No. 297 forces an increased burden on the consumers of the Respondent herein and, at the same time, hastens the day when Respondent will be forced to recall or recapture the electric power and energy in question, which capacity and energy experience and trends indicate that Georgia Power Company will be forced to replace at a greatly increased cost, and that such cost must be ultimately borne by the public it serves.

III

That this contract was arrived at by arms length bargaining between two entirely non-affiliated electric utilities to the mutual benefit of their respective consumers, and that the courts have said that "the purpose of this chapter is to correct abuses of write-ups, inflation of account, and similar practices which have on occasion been found in the utility industry" and there is no evidence in the record to indicate that any of these factors exist here, all of said evidence being, in fact, to the contrary. *Connecticut Light & Power Co. vs. FPC.* 141 F (2nd) 14 (1944). Further, there is no evidence to show that any of such abuses did or do exist and, in fact, the record discloses clearly that none of them—or any other abuse or related practice—did or do exist. Absent such showing, there can be no action by the Federal Power Commission under this section to alter the rates and charges in question.

IV

That the South Carolina Public Service Commission has thoroughly and carefully scrutinized the operations of the Respondent company, including the contract here in issue, *ab initio* and throughout their respective existences, and has found clearly and repeatedly that this contract is in the public interest. This Commission has further found that the action of the Federal Power Commission in ordering a revision of this contract will have a harmful effect upon that portion of the public served by the South Carolina Generating Company and its parent company, and invites the Federal Power Commission's attention to the fact that the purpose of that portion of the Federal Power Act under which this proceeding was initiated and carried out, has been stated by the courts as being one "intended to supplement and not to supersede the regulatory power of the States." *Arkansas Power & Light Co. vs. FPC,* 156 F(2nd) 821 (1946). The South Carolina Public Service Commission respectfully submits to the Federal Power Commission that the Federal Power Commission's actions in this instance completely supersede and disregard the regulatory power of the State of South

Carolina as the same is vested in the South Carolina Public Service Commission, and should therefore be set aside.

V

That the action of the Federal Power Commission in reducing the rates and charges in the contract in issue will be directly harmful to the public interest in that it will severely retard the free contracting between public utilities so necessary to continue to give this country a free flow of power over interconnected transmission systems, and the working out of many arrangements which will decrease the power costs to ultimate consumers. Therefore, the action of the Federal Power Commission herein complained of is beyond its power as the same is vested in it by the Federal Power Act, or any other law or regulation having the force and effect of law.

VI

That the South Carolina Public Service Commission respectfully invites the attention of the Federal Power Commission to the fact that one of the factors looming large in the approval by the South Carolina Public Service Commission of the contract under consideration in this proceeding wherein the South Carolina Generating Company agreed to construct a steam electric generating station and therefrom to export power out of the State of South Carolina to the State of Georgia was the fact that it was beneficial to the public of the State of South Carolina because the said contract contained a stipulation that upon due notice all or a portion of the power thus sold and exported from the State of South Carolina could be recalled and recaptured at will by the vendor. While the question of recall or recapture is not directly in issue in the case at bar, the Federal Power Commission in footnote No. 8 to its Opinion No. 297 herein has indicated that such recall or recapture is within the control of the Federal Power Commission. The South Carolina Public Service Commission respectfully invites the Federal Power Commission's attention to the fact that on the basis of the foregoing stated approval by it of the contract in question

and the statement included in the said footnote No. 8 to Opinion No. 297 the Federal Power Commission is attempting to completely supersede an effective area of regulation and control by the South Carolina Public Service Commission in its protection of the public interest with which it is charged by the statutes of South Carolina, and that such action is contrary to the authorities above cited and repugnant to the Federal constitution.

VII

That the record clearly shows that the parent company of the Respondent assumed many burdens in order to effect what was originally designed as low cost power to be consumed in South Carolina. The Federal Power Commission's action in reducing the rates in question results in giving a benefit to a considerably larger company with somewhat lower rates and placing the resultant greater burden upon the smaller of the two companies whose rates are somewhat higher due to its geographical location in relation to fuel sources, all of which could not by any stretch of the imagination be in the public interest, but would in fact be clearly detrimental to the same.

VIII

That the Federal Power Commission's action in striking down the majority of the escalation clauses is against the public interest in that in its consideration of this contract aforesaid the South Carolina Public Service Commission considered these as an integral part of the contract and its rate. Regulatory lag necessitated by discarding the escalation clauses not only involve a loss of considerable sums before proper increases are granted, but entails considerable additional financial burden in securing such increases, none of which were envisaged by this Commission when it approved the aforesaid agreement. This Commission respectfully invites the attention of the Federal Power Commission to the fact that escalation clauses are a basic and integral factor in modern day business contracts, and that they have been approved by almost all regulatory bodies, and that its action aforesaid not only places an undue burden upon Respondent but will discourage the formulation of similar agreements

in the future, which agreements tend to lower the cost of power and increase the availability thereof in the public interest.

South Carolina Public Service Commission

By Clyde Boland, *Chairman.*

ATTEST:

J. N. LAND, JR., *Secretary*

November 21, 1956

Columbia, South Carolina

Before Commissioners: Jerome K. Kuykendall, *Chairman;* Seaborn L. Digby, Frederick Stueck, William R. Connole and Arthur Kline.

In the Matter of
South Carolina Generating Company
Docket No. E-6585

ORDER DENYING PETITIONS FOR REHEARING

(Issued December 20, 1956)

On November 23, 1956, South Carolina Generating Company, the South Carolina Public Service Commission and the Georgia Public Service Commission filed petitions requesting rehearing of this Commission's opinion No. 297 and order issued October 24, 1956, in this docket. That order directed South Carolina Generating Company to reduce its rates for the sale of electric energy to Georgia Power Company by $252,186 annually. Since, for the most part, the petitions seek to relitigate issues already fully considered, it is appropriate to consider briefly herein only a few of the issues raised by the petitioners.

Generating Company argues that the terms of the contract between it and Georgia Power Company are not subject to modification by the Commission under the doctrine of *Federal Power Commission v. Sierra Pacific Power Company,* 350 U. S. 348, "because there is no showing that the rates and charges . . . are *so high,* as to impair 'the financial ability' of Georgia (Power Company) 'to continue its service, cast upon other consumers an excessive burden or be unduly discriminatory' or otherwise adversely affect the public inter-

est." (Emphasis added.) This argument misinterprets the holding in the *Sierra Pacific* case, *supra,* and apparently would have us entirely disregard the effect of Generating Company's proposed rate-making policy upon ultimate consumers whom the Act is designed to protect. *Cf. Federal Power Commission v. Hope Natural Gas Company,* 320 U. S. 591, 610.

In the *Sierra Pacific* case, the Court was dealing with an entirely different situation from the one confronting us here. In that case, the seller had agreed under contract to a rate lower than its cost of service, including a reasonable rate of return. Later, it attempted unilaterally to increase the rate. "In such circumstances", the Supreme Court held, "the sole concern of the Commission would seem to be whether the rate is so *low* as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." (Emphasis added.) 350 U. S. 348, 355.

In final analysis, this argument of Generating Company is but another aspect of the value-of-service theory which we rejected in opinion No. 297. In its petition the South Carolina Commission also urges acceptance of the value-of-service theory in determining just and reasonable rates. Obviously, if our jurisdiction over contract rates did not attach except under the circumstances proposed by Generating Company, the criteria of a just and reasonable rate would no longer relate to cost of service on a net investment rate base, but would be based upon what the traffic would bear. We reemphasize our finding in opinion No. 297 that the public interest will not permit the use of the value-of-service formula as the Generating Company would have us apply it and we adhere to the cost-of-service approach enunciated in that opinion. The *Sierra Pacific* case does not require otherwise. On this basis, the substantial evidence demonstrates that the contract rate between Generating Company and Georgia Power Company is unjust and unreasonable.

Additionally, Generating Company and the South Carolina Public Service Commission argue that the elimination of escalation provisions affecting the capacity component of the

rate to Georgia Power Company will add to regulatory expense and result in a lag in recovery of costs. Generating Company is protected from changes in fuel costs affecting clause. With regard to the escalation clauses affecting the capacity component, it should be noted that the capacity component of the rate to Georgia Power Company is based upon recovery of capacity costs associated with the output of one-half of the total capacity available from two 75,000 kw generators at Plant Urquhart. Confronted with this relatively stable capacity cost situation, the primary problem is not the recovery of unknown and conjectural increases in capacity costs which might occur, but the maintenance of a just and reasonable rate under conditions of a declining rate base. Under these conditions it is probable that the regulatory lag would work more to the seller's benefit than to its detriment.

Generating Company further requests that the Commission, in its use of the 1956 test year, give effect to a number of changes which have taken place since the close of the record in this proceeding on July 20, 1955. Included among these changes are a purported change in the debt-equity ratio of the South Carolina Electric & Gas System and an increase in the South Carolina state income tax from 4.5% to 5% effective as to income tax accounting periods after June 30, 1956. If we were to reopen the proceedings for the purpose of bringing the record up to date, it would be appropriate to take evidence on all aspects affecting the cost of service to Georgia Power Company. Thus, it might well be determined reasonable to shift from 1956 to 1957 as the test year in determining rates for the future. In this regard, it is clear from Generating Company's evidence now before us that the effect of the declining rate base applicable to sales to Georgia Power Company would outweight the effect of any changes purported to have taken place since the close of the record tending to increase the cost of service. Furthermore, the delay caused by the reopening would, in all probability, result in a lapse of time in which additional changes would occur. Effective regulation and orderly administrative procedure require that there be an end to these proceedings. The rates which we prescribed are based upon the substantial evidence in the record before us. It would not

be in the public interest to prolong these proceedings which have already extended over a period of more than two years. *In the Matters of Michigan-Wisconsin Pipe Line Company,* Docket Nos. G-1678 and G-1996, Opinion No. 275, issued July 30, 1954; *In the Matter of The Ohio Fuel Gas Company,* Docket No. G-2281, order denying rehearing issued August 16, 1956. *Cf. City of Detroit v. Federal Power Commission,* 230 F. 2d 810, 822-823 (CADC, 1955), *certiorari* denied, 352 U. S. 829.

It is urged by the South Carolina Public Service Commission that our order regulating the rate for the sale of electric energy to Georgia Power Company supersedes an effective area of its regulation and control. We think that, clearly, it does not. The rate over which we have exercised our jurisdiction is a rate for the sale of electric energy at wholesale in interstate commerce within the meaning of Sections 201, 205 and 206 of the Federal Power Act and we so found. The wholesale sale to Georgia Power Company is within the category of transactions which Congress intended to regulate. S. Rep. No. 621, 74th Cong., 1st Sess., p. 48 (1935); H. Rep. No. 1138, 74th Cong., 1st Sess., pp. 7-8 (1935). And it was with respect to such wholesale sales that the Supreme Court held the states had no jurisdiction in *Public Utilities Commission v. Attleboro Steam & Electric Company,* 273 U. S. 83 (1927), thus giving rise to the enactment of the Federal Power Act.

In regulating this rate, we must consider the interests of both the producing and the consuming states. This fact is underscored by the active participation in this proceeding by the Georgia Commission representing interests of consumers in Georgia. Notably, the Georgia Commission seeks an even greater reduction in Generating Company's rates than we ordered. It is significant also that the Georgia Commission was prepared to accept our determination if it would have resulted in a prompt resolution of the issues with resulting immediate benefits to the ratepayers of Georgia Power Company. It was only the announced intention of Generating Company to seek rehearing that constrained the Georgia Commission to renew its contention for the lower rates.

The Georgia Commission also urges that we find the contract rate between Generating Company and Georgia Power Company to be unduly discriminatory. Under the circumstances of this case, our finding that the contract rate was unjust and unreasonable and our determination of a just and reasonable rate made it unnecessary to make a formal finding of undue discrimination.

The Commission further finds:

The petitions for rehearing of our opinion No. 297 and accompanying order issued October 24, 1956, set forth no facts and no principles of law which either were not fully considered by the Commission when it adopted the opinion and order or which having now been considered warrant any change in or modification of such opinion and order. All contentions and objections not specifically discussed herein have been considered and found either without basis in law or support in fact but are not sufficiently material to warrant individual treatment or have been adequately disposed of otherwise.

The Commission orders:

The petitions filed on November 23, 1956, by South Carolina Generating Company, the South Carolina Public Service Commission and the Georgia Public Service Commission for rehearing of our opinion No. 297 and accompanying order issued on October 24, 1956, are hereby denied.

By the Commission. Commissioner Digby dissenting.

J. H. GUTRIDE, *Acting Secretary*

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DEC 31 1957
JOHN T. FEY, Clerk

APPENDIX TO PETITIONER'S BRIEF

IN THE

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 7391

SOUTH CAROLINA GENERATING COMPANY,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

No. 7393

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

ON PETITIONS FOR REVIEW OF AN ORDER
OF THE FEDERAL POWER COMMISSION

FILED
MAR 29 1957
R. M. F. WILLIAMS, JR.
CLERK

Petitioners' Appendix
Part II

THE STATE COMMERCIAL PRINTING CO.

INDEX

Cases Nos. 7391 and 7393

PART I

Page

Petition of South Carolina Generating Company for Review 1

Petition of South Carolina Public Service Commission for Review 9

Federal Power Commission Order Initiating Proceeding 13

Answer of South Carolina Generating Company 19

Decision of Presiding Examiner of Federal Power Commission 29

Opinion No. 297 of Federal Power Commission Reversing Decision of Presiding Examiner 93

Petition of South Carolina Generating Company to Federal Power Commission for a Rehearing 121

Petition of South Carolina Public Service Commission to Federal Power Commission for a Rehearing..... 131

Federal Power Commission Order Denying Petitions for Rehearing 135

INDEX

PART II

Page

Statement 141

Direct Testimony of Harllee Branch, Jr. 142

Cross-Examination of Harllee Branch, Jr. 145

Redirect Examination of Harllee Branch, Jr. 149

Direct Testimony of Albert H. Gordon 150

Cross-Examination of Albert H. Gordon 157

Redirect Examination of Albert H. Gordon 159

Recross Examination of Albert H. Gordon 159

Direct Testimony of F. R. McMeekin 159

Direct Testimony of W. J. Ready 169

Additional Direct Testimony of W. J. Ready 176

Cross-Examination of W. J. Ready 184

Direct Testimony of J. M. Costello 191

Cross-Examination of J. M. Costello 194

Statement of Chairman of South Carolina Public Service Commission 199

Direct Testimony of Dale E. Goubleman 209

Direct Testimony of Kenneth L. Smith 215

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Petitioner.

VERSUS

FEDERAL POWER COMMISSION,
Respondent.

Petitioners' Appendix

Part II

Pages 141 to 227

STATEMENT

In its order setting the hearing in this investigation the Federal Power Commission ordered that the direct testimony of the South Carolina Generating Company be served in advance of the hearings. For that reason the direct testimony of each of the witnesses was given an exhibit number.

To the direct testimony of some of the witnesses, statements were attached as parts of the witnesses' evidence. It is our view that it is unnecessary to reproduce these statements as a part of this appendix. If, in the preparation of briefs, a different conclusion is reached as to any of the statements it is our intention to furnish such statements for the use of the Court and of counsel.

The contract in issue here (Exhibit A) between the South Carolina Generating Company and the Georgia Power Company is not printed but sufficient copies for the members of the Court will be filed.

Since the orderly preparation of briefs requires that this Appendix be printed prior to the filing of the record by the Federal Power Commission the pagination herein may vary from that in the certified record.

TESTIMONY SUBMITTED BY THE SOUTH CAROLINA GENERATING COMPANY

EXHIBIT 1

DIRECT TESTIMONY OF HARLLEE BRANCH, JR.

1. Q. Will you please state your name, address, and position with the Georgia Power Company?

   A. My name is Harllee Branch, Jr. I reside at 3106 Nancy's Creek Road, Atlanta, Georgia. I am President of Georgia Power Company.

2. Q. As the President of Georgia Power Company, did you have general supervision of negotiations in connection with the contract which was finally executed between your Company and the South Carolina Generating Company on November 9, 1951?

   A. Yes. The negotiations were actually handled by other representatives of our Company. However, as President of the Company I directed that the negotiations be undertaken and was kept generally informed of their progress. I signed the contract of November 9, 1951 for the Georgia Power Company.

3. Q. In the early part of 1951 did the Georgia Power Company have under consideration the building of generating capacity in the Augusta area?

A. Yes.

4. Q. At or about that time did the Georgia Power Company acquire a power site and have on order a 60/66,000 KW steam generating unit for installation near Augusta, Georgia?

A. Yes. Formal commitment for the purchase of a turbo-generator with optional capacity between 40,000 KW and 100,000 KW was made on September 25, 1950. Late in May 1951 it was decided to make this unit 60,000/66,000 KW. A power site near Augusta was selected and we began acquiring options in the Spring of 1951. Title to the tract was acquired during the Summer of 1951.

5. Q. In connection with the power needs of Georgia Power Company in the Augusta area, did you authorize your company to begin negotiations with South Carolina Electric and Gas Company for a source of power for the Augusta area?

A. Yes.

6. Q. In determining whether to enter into the proposed contract with South Carolina Generating Company, did the Georgia Power Company consider the possibility of obtaining an equal amount of electrical energy from other sources, including the construction of its own steam generating plant in the Augusta area?

A Yes.

7. Q. After considering all of the possibilities, what conclusion did the Georgia Power Company reach with reference to the desirability of entering into the contract for this electrical energy with South Carolina Generating Company?

A. The Georgia Power Company concluded that its best interests would be served by contracting with the South Carolina Generating Company for this supply of electrical energy. This decision was based upon the following considerations:

(a) The cost of power from a two-unit plant is cheaper than the cost of power from two single-unit plants built at approximately the same time and in the same locality;

(b) Plans for the South Carolina plant, only about two miles from our proposed site, were further advanced, and it was felt that the needed power supply for the Augusta area could be obtained more quickly and more cheaply from that source;

(c) Special financing, not available to our Company was possible for the South Carolina plant. The South Carolina company offered to share these benefits, together with other savings in construction and operating costs, with our Company.

(d) Our Company was, and had been for a number of years, involved in a large expansion program so that it was considered desirable to limit our capital outlays wherever possible without prejudicing our service or rates. This could be done by purchasing our power requirements for the Augusta area; and

(e) It was possible for our Company to obtain additional service protection by contracting for power from a two-unit plant with the right to utilize one-half of whatever capacity was available at the plant in the event of a unit failure.

GEORGIA
FULTON COUNTY

Personally appeared Harllee Branch, Jr., who being duly sworn says that the foregoing answers are true.

(Signed) HARLLEE BRANCH, JR.

Sworn to and subscribed before me
this 5th day of April, 1955.

(Signed) ROY HARWELL
Notary Public, Fulton County, Ga.

Notary Public, Fulton County, Georgia
My Commission Expires April 26, 1958.

CROSS-EXAMINATION OF MR. HARLLEE BRANCH

(77) Cross-Examination by MR. WAHRENBROCK:

* * *

(84) Q. Then at the time of the beginning of the negotiations between the two companies, the Electric and Gas had only a plan for a single unit station in mind?

(85) A. That's my assumption, and I am quite sure that is true because, as a matter of fact, my recollection is that it was my company that first broached the idea of building capacity for our use into that plant.

* * *

(95) I will say this to you, that I understood throughout the course of those negotiations that South Carolina Electric and Gas Company would not be willing to build capacity into a plant which it in effect was financing in addition to its own capital requirements for our benefit unless they had a right of recapture; and we were not willing for them to have that right of recapture unless we were given an adequate time within which to build substitute capacities if they exercised that right.

We fully understood that at such time as it might be either necessary to carry their loads, or because of the economic advantage of it, for them to recapture that capacity, yes, they would capture it.

* * *

(97) Both in government power contracts that we have had occasion to negotiate and in a vast number of contracts we are familiar with, the idea of a recapture at the instance of the party constructing or owning the plant is not unusual.

* * *

(98) Since 1945 my company—and it is not a big company—has been building new plant at the rate of $35 million to $50 million a year. That is a whale of a lot of new capital to try to digest into your system.

Any construction of this kind, which on an economical basis we can forego and still not have it detrimentally affect our ability to carry our loads and to officially serve our customers, is a big advantage to us.

That is what I meant, hoping to avoid. We wanted to carry our load efficiently, as we have always tried to do; but if somebody else would build the plant for me and do it on terms that would compare favorably with my cost, I was delighted to have them carry a part of my burden for me.

• • •

And I might say I think it is a direct advantage to my ratepayers to avoid as much of that capital expansion as I can because of the fact that we thereby less dilute our capital structure and have to acquire or obtain less new financing and the results of that ultimately, I believe, is a saving and a benefit to them as well as to the company.

• • •

(99) Q. A saving in what respect?

A. In this respect, and in this specific instance: We were able in this particular case to have a plant built at a money cost—and our 75,000 kilowatts—at a money cost appreciably more favorable than would have been possible under our capitalization ratios to build the same capacity.

To that extent it was not just a benefit to the company, but it was a benefit to the rate payer in that any expense which enabled us to hold our rates and our expenses at the existing level, was more favorable than one that might have compelled a rate increase.

• • •

(102) I should say that because it had an impressive effect on us and I think you are entitled to know it, that when we compared the difference between a $27.80 cost to the Georgia Power Company per kilowatt of capacity in the plant we were proposing, against a possible $16.50 per kilowatt of capacity in a joint plant under special financing, we also did not overlook the fact that we would get the total additional benefit of the difference in efficiency in the larger unit being (103) a 75,000 kilowatt unit as compared with a 66,000 kilowatt unit.

PRESIDING EXAMINER: You sound as though you still think you made a good contract.

THE WITNESS: I am quite sure we did make a good contract from the standpoint of cost to the Georgia Power Company. I wouldn't have made it if I hadn't.

• • •

(106) Q. With the benefit of hindsight, would you say that the company might have been in a better position so far as cost of production is concerned if it had constructed at the time you had that plant under consideration?

A. No, sir. I think the contract was good at the time it was made and I think it is still a good contract.

• • •

(114) Q. Do you know whether in fact your company, by reason of your 25-year contract with the Generating Company, does in effect, however, guarantee the payment of substantially more than half of Generating Company's total interest, amortization, taxes, and operation and supervision costs?

A. I don't know that and have no knowledge of what proportion of their total costs it is. The only thing I do know is this, that it is a saving to me. In my business, I am not adverse to somebody else making a profit if I can also make a profit for myself.

• • •

(125) Q. Did you know at the time whether they would have adopted the special financing if it had not been for your participation?

• • •

A. I certainly say this, and that is the reason I am a little embarrassed about these proceedings in addition to feeling that we made a good contract. I know, because my people sat in on some of those discussions, that investors who financed this plant took Georgia Power's contract into consideration in their willingness to finance this plant. So I was informed by my people, and I am therefore embarrassed and concerned if the contract should be altered or set at naught, for the impact—maybe I ought not to say this, but I am seriously concerned—that that might have on any future efforts to do what I understand this Commission would like to see these independent companies do, and that is integrate

their systems and build capacity one for the other wherever (126) it is cheapest.

Q. Then it is fair to say, is it, that you feel your participation made possible the financing and the method that was adopted and the construction of a two-unit plant?

A. The second unit. I think they could easily have financed on the H-bomb contract and their own service the one unit. They may have financed a two-unit plant, but certainly ours did enter into the willingness of the investors to finance the second unit. I think that is a fair statement.

Q. So your participation then did in effect make available to that system, Electric and Gas, benefits corresponding to your own from reduced costs of financing and from the economies of a two-unit plant.

A. Yes, sir, and I should say this to you, Mr. Wahrenbrock. We did what I thought was some right rough trading. We insisted that at some stage South Carolina would build a second unit in that plant anyhow. If we helped them finance the second unit, it would become the third unit and I think it is now under construction or contemplation.

We said to them, "Anything that you build into this first two-unit plant will have a value to your ultimate three-unit plant, and we want some concession based on that value." We were trading pretty close. We finally got around to what our engineers believed to be a reasonable allowance for that, and my recollection is that it was in the order of $200,000, and (127) allowance of costs, benefit or saving, on a third unit when and if it might be constructed.

We were gratified that in the final wind-up of the contract South Carolina recalculated and allowed us an additional $300,000 on that account. I believe it was $500,000.

Q. Perhaps I may suggest that it is now $581,000 instead of $200,000.

A. That is what I am trying to say. It went up some $300,000.

* * *

(130) Q. I am not passing any judgment on this.

When you say that your decision to purchase was based in part on the fact that special financing not available to Georgia Power Company was possible for Urquhart, why

wasn't the same method of financing available to Georgia Power Company?

A. One, we did not have the justification of the H-bomb plant which had produced such special financing, not only in this case but in Paducah; and I think since that time another case. We didn't have that angle.

But I would like to say to you, sir, that we had inquired of the Securities and Exchange Commission, which we are subject to and I am not sure South Carolina is, and we had applied to them about the possibility of some unorthodox financing for some of the tremendous amount of additional capacity we were having to build. We were told by the staff at that time that we could not construct. Why, I don't know.

I am a fellow who believes it might be advantageous to (131) the rate payer sometime to be a little less categorical in these ratios. But that doesn't seem to be the current regulatory thinking.

PRESIDING EXAMINER: You can't tell why. You just say you couldn't?

THE WITNESS: I don't know why they said it, but I know I would not have been permitted to do it.

* * *

(149) Redirect Examination by MR. ROBINSON:

* * *

(150) Q. I understand. Now you were going to give us some figures on the savings on energy. I wonder if you could give us those?

A. Maybe I am just volunteering, but I thought you would be interested in them. In addition to the differential in capacity cost, which I mentioned earlier, at the time of our estimates in May 1951, it appeared that fuel cost in the South Carolina joint plant, if constructed, would cost 3.27 mills per kilowatt hour against 3.50 mills per kilowatt hour in the 60 to 66,000 kilowatt unit we had in mind in the Augusta area.

* * *

(152) Q. You were about to give us the factors which in your opinion would justify a lower rate to duPont, had its

plant located in Electric and Gas territory than to a customer outside of that territory. What are those factors, Mr. Branch?

* * *

A. I was about to say that in setting a price for power to be sold to one to whom you bear no utility obligation, and therefore you have a complete freedom to serve or not serve, there are factors over and above the mere cost of generating and delivering the power.

For example, I think that my company, while it would be required not to differentiate in the cost of power toward customers of its own to whom it had each a utility responsibility, if they were taking the same class of service under similar and constant conditions, would nevertheless, if approached by someone to whom they had no utility responsibility, take into consideration the fact that the customer within their borders was contributing to the general economic level or the general economy which they served, that it might be in the case of a (153) large industry providing jobs, plants and purchasing power which might in turn be reflected in the ability of a number of persons within the utility's territory to buy and utilize larger amounts of electricity.

PRESIDING EXAMINER: Let me ask you right in that connection, now: Do you mean to imply—I am just trying to find out what you really mean there—do you also mean to imply that you haven't quite said that those very considerations might in turn advantageously affect future costs overall?

THE WITNESS: Yes, I think they would. And the ultimate cost of the utility company, as its economy builds up, the costs or the return to the utility in serving that area I think would be improved and the costs proportionately improved.

Exhibit 4

DIRECT TESTIMONY OF ALBERT H. GORDON

Q. Please state your name and address.

A. My name is Albert H. Gordon, and my address is 10 Gracy Square, New York, New York.

Q. What is your business background, Mr. Gordon?

A. I am a graduate of the Harvard Business School, and since 1931 have been a partner of Kidder, Peabody & Co. I have been a Vice President of the Investment Bankers Association, and a member of the Board of Governors of the New York Stock Exchange. I have testified before many tribunals, including the Federal Power Commission as an expert witness in security matters.

Q. What is the general background of the firm of Kidder, Peabody & Co.

A. Kidder, Peabody & Co. was founded in 1865, and has offices at 17 Wall Street, New York City, and additional offices in Chicago, Philadelphia, Boston, San Francisco and other cities. It is one of the leading investment banking firms in the country, and has engaged in considerable public utility work.

Q. Would you outline Kidder, Peabody & Co.'s financing experience with South Carolina Electric & Gas Company and its subsidiaries?

A. Of the present securities outstanding of the South Carolina Electric & Gas Company, Kidder, Peabody & Co. acted as banker in the public or private sale of all of the bond issues except one and all of the preferred and common stock issues. Kidder, Peabody also negotiated the private sale of one of the bond issues of the former South Carolina Power Company; $12,000,000 bond issue of South Carolina Generating Company in February 1954 and placed privately the original $4,500,000 bond issue in 1953, and the $4,000,000 refunding issue in 1954 of the South Carolina Natural Gas Company.

Q. Are you familiar with the original financing in 1951 of the South Carolina Generating Company in which the Company obtained commitments to sell $20,000,000 of First 3⅜'s 1979 and $4,000,000 of 4% notes due 1964?

A. Yes. The company negotiated this private placement directly with institutional investors.

Q. Would you give your opinion as to the contribution made by South Carolina Electric & Gas Company to the success of financing the Generating Company?

A. This financing in my opinion would have been impossible without the aid afforded by South Carolina Electric & Gas Company. The success of the Generating Company's financing and the favorable rates on its debt securities were due to:

(1) Affiliation with an established electric utility;

(2) Assurance provided by the parent company that additional equity funds would be made available as needed to complete the project;

(3) Guarantee by the parent of the debt principal and interest and related commitment fees during the period of construction;

(4) Guarantee by parent against any deficiency in insurance in the event that the station is destroyed or partially destroyed, and

(5) Assurance as to revenue to service the entire debt securities including sinking funds of the Generating Company plus a margin or cushion equal to 8% of the equity. In my opinion these commitments by the parent were essential to the successful placement of these securities.

Q. Would you state your opinion as to the effect on cost of financing of the South Carolina Electric & Gas Company which resulted from creation of a seprate Generating Company subsidiary and financing it as was done?

A. In my opinion investors regard the Generating Company being 100% owned as an integral part of the South Carolina Electric & Gas system. Investment bankers and institutional investors give considerable weight to consolidated statements in appraising all types of securities, bonds, preferred and common stock. This is particularly true of common stock. Many dividend restrictions are geared, as in this instance for example to the consolidated common stock equity ratio rather than to the ratio of the company alone. Security analysts generally employ the consolidated ratio when analyzing the investment position of a utility common stock. Inclusion of the Generating Company with its 90% debt capital resulted in the consolidated common stock equity ratio increasing only from about 26% in 1951 to about 28% in 1954 despite heavy common stock financing by the parent, while the common equity ratio of the parent increased from 26% in 1951 to 35% in 1954. In my opinion the effect on the

consolidated statement of including Generating Company subsidiary resulted in a higher cost of parent company bonds, preferred and common stock capital than otherwise would have prevailed, and it resulted in the need for unusually large common stock financing by the parent company.

Q. What do you consider to be desirable capitalization ratios for the South Carolina Electric & Gas Company?

A. In recent years we have witnessed a tendency on the part of utility companies to strengthen the ratio of common stock equity to total capitalization. In most cases this has been carried out despite a heavy amount of total financing requirements. At the end of 1953, the latest period for final industry averages, for Class A and B privately owned electric utilities as reported by the Federal Power Commission industry averages amounted to 49.8% for total debt, 12.8% for preferred stock and 37.4% for common stock and surplus. In our experience of financing utility common stock we have found the greatest frequency ranging from about 39% to 40%, and from our experience and conversations with institutional and individual investors, I would conclude that a ratio in the neighborhood of about 35% is desirable and generally acceptable.

Considering uncertainties engendered by present and possible competition from public power bodies in the territory served and the effect on operating costs of widely varying hydro electric output, I believe that South Carolina Electric & Gas Company should establish conservative capitalization ratios. In my judgment a common stock equity ratio of 35% would be appropriate.

Q. Do you have an opinion as to an appropriate ratio of debt in percentage of total capitalization for this Company?

A. Ratio of debt total capitalization is one of the most important elements in appraising the investment position of a utility company's bonds. While such ratios range all the way from about 40% to 60% the majority of cases fall within a range of about 45% to 55%. Many bond indentures specify 60% as a maximum of bonds to net plant additions. I believe it is important for a utility to strive for a conservative debt ratio and in my opinion it would be desirable to have as an objective a ratio of about 50% or less.

about 50% of total capitalization for debt
common stock, this would leave about 15% for
stock. Would you consider such a ratio to be a
for preferred stock?

Yes, I would.

Mr. Gordon, would you state how these capitalization
with the South Carolina Electric & Gas sys
at the end of 1951 and as to the effect
of such objectives would have on future

capitalization ratios to which I testified as de
ratios of 50% debt, 15% preferred stock and 35%
compare with actual company system ratios at
1951 of about 62.08% debt, 9.4% preferred stock
common stock.

evident as the system continues to expand the
must sell common equity amounting to more
net plant additions and preferred stock in ex
In order to reach such desired capitalization
of equity money is greater than debt money,
of financing will be greater than normal until
capitalization ratios have been attained.

Mr. Gordon, using present system capital ratios and assum
ratios to which you have testified as objec
will you give your opinion as to the amount of earn
to finance the continued growth of this system?

Based on experience in financing utility companies,
I believe that the amount of earnings needed to
meet the external requirements of this system is in
the neighborhood of 6% or more. Cost of raising capital for
the near future will for some years amount to
more than industry averages, in part because of
the need for creation of stronger capitalization ratios as
described, particularly common stock.

Q. Present and potential competition from public power
projects and

A. Widely varying hydro electric output.

The electric power industry as a whole earned about 6.2%
on net plant for 1951 based on Federal Power Com
mission preliminary figures for Class A and Class B utilities.

approximately the same percentage return as in 1953 based on final figures. This is exclusive of any consideration for working capital or pending applications for rate increases, allowance for which would probably still leave the earnings return at somewhat over 6%. In other words, funds for construction of existing electric plant have been financed based on earnings produced and allowed amounting to about 6% or more.

Q. Have you given consideration to other elements in arriving at estimated earnings requirements of 6% or more?

A. I have also considered cost of financing the company's individual components of capital, that is bonds, preferred and common stock.

Q. What is your opinion as to the cost of debt capital for this Company?

A. I believe that an appropriate allowance for debt cost would be in a range of about 3½% to 3¾%. Bonds of the company are now rated "Baa" and while a debt ratio of 50% or less should result in higher rating, capital costs are still likely to reflect the existence of potential competition from public power authorities and other factors previously mentioned. In recent years of unusual strength in the bond market, records shown by Ebasco Services, Inc. indicate that "Baa" utility bond offers have cost utilities which are predominantly electric net money rates ranging from about 3¼% to 4%.

Q. What would you estimate for cost of preferred stock capital?

A. Preferred stock capital for utility companies usually costs about ½% to 1½% higher than the cost to them of bond money. For this Company I would estimate a range of about 4½% to 5%.

Q. What would you estimate for cost of common stock capital?

A. With respect to common stock I believe that earnings of about 10% or more are needed to assure success of common equity financing.

Common stock investors are concerned largely with prospective earnings and consequently determination of costs of common stock capital must be based primarily on the rela-

tionship of prospective earnings and net proceeds from financing.

Earnings projections of $1.60 per share have been estimated by officials of South Carolina Electric & Gas Company in recent years at open meetings of the New York Society of Security Analysts and such estimates have been generally available to the public. In view of recent reported earnings, growth in the company's business and apparent prospects for continued expansion, I believe that the average investors buying the stock of this company do so on the basis of anticipated earnings of $1.60 per share or more. Recent market prices of about $19 for the stock are about midway between the high and the low for 1955 of 19⅞ to 17⅞. The subscription price of $17.50 at which additional stock was sold under rights to existing stockholders effective February 24, 1955 is approximately 8% under present market prices which is about average for underpricing in a utility company's rights offer. After allowing for underwriting fees and estimated company expenses the net to the company was about $16.90 per share. Anticipated earnings assumed at $1.60 amount to about 9.5% of net proceeds from the financing.

Q. Would you say that earnings of about 9.5% are sufficient under present market conditions to provide for common stock financing?

A. No. It is my opinion that 9.5% or more represents approximate minimum bare-bones cost of financing for this company under present market conditions. In order to provide reasonable assurance as to the successful financing it is essential to have an adequate margin of earnings, over and above the bare-bones cost of common stock capital to compensate among other factors for (1) Incentive for efficient and aggressive management and organization, and adequate and good service, (2) margin for possible error in calculating costs of capital, and (3) attrition or long term trend toward lower earned rates of return due to higher unit costs. In this instance provision for such a margin over bare-bones cost of capital would, in my judgment, require earnings amounting to about 10% or more under present market conditions. Present prices for utility common stocks are the best they

have been for the past 25 years or more and consequently I would regard an earnings requirement of 10% for successful financing for the company as a probable minimum.

Q. You have testified that the amount of earnings estimated to be required for reasonable assurance of successful financing under nearby market conditions is for bonds 3½% to 3¾%, preferred stock 4½% to 4¾% and common stock 10% or more. What would these rates of earnings amount to on an overall basis?

A. Assuming capitalization ratios at objective of 50% bonds, 15% preferred stock and 35% common stock, such rates of earnings on overall bases would range from about 5.93% to 6.09%. However, in order to attain consolidated capitalization ratios of 50% debt, 15% preferred and 35% common this company must finance over the next several years with larger proportions of equity securities, and, therefore, the overall rates of earnings needed to assure successful financing would be in excess of the range of 5.93% to 6.09%.

Q. What are your conclusions as to earnings necessary to provide the basis for successful financing of this system?

A. On an overall basis I believe that earnings of at least 6% are necessary to afford reasonable assurance for successful financing of the South Carolina Electric & Gas system in the near future.

CROSS-EXAMINATION OF MR. A. H. GORDAN

(158) Cross-Examination by MR. WAHRENBROCK:

* * *

(209) A. There is quite a difference between nullify, and "tend to nullify." I would say that it increased some of the costs for the system. I would doubt very much if it nullified it. The first obligation of the company is to furnish adequate service in its territory. By this method of financing it was enabled to render adequate service in its territory.

If it had not been able to take care of the AEC requirements, there might have been an adverse effect on the part of the investor towards the company.

* * *

(214) A. Overall, it seems to me to have been to the advantage of the company, looking ahead for its cost of money, to have built the Urquhart Plant. It was necessary to have this kind of capitalization in order to be able to get the AEC contract. Therefore, it was in my opinion in the interests (215) of the company to adopt this unconventional method for the advantage that it gave, and therefore it obviously should be the goal of the company to gradually achieve a conventional average equity base.

* * *

(342) MR. WAHRENBROCK: No further questions, Mr. Examiner.

PRESIDING EXAMINER: Georgia?

By Mr. Knowles Davis:

* * *

(343) Q. Does South Carolina Electric and Gas guarantee in any way the payment of the bonds which were issued by the Generating Company?

A. Yes, it has given assurance that there will be a sufficient payment for the bonds to take care of the interest and amortization.

* * *

(364) Q. You testified on direct that, based on your experience in financing utility companies, a return of about six percent or more would be required for this system, as your testimony reads. I am interested in what you mean by "this system." Do you mean on a consolidated basis of Electric Gas and Generating Company, or are you speaking of Electric and Gas by itself, or Generating Company by itself?

A. By the consolidated.

Q. In what way does an earning of six percent on a consolidated basis have an effect on the earning requirement of Electric and Gas?

A. That amount of earnings is necessary to make possible (365) the next financing.

* * *

(381) RE-DIRECT EXAMINATION

By Mr. Robinson:

* * *

(382) Q. Mr. Gordon, you were asked something about the variable earnings of the South Carolina Electric and Gas Company due in part at least to the water situation. Do you have the earnings per share of common stock over recent years? Would you read those into the record for us?

A. Yes. The earnings in 1946 were 80 cents a share; 1947, 74 cents a share; 1948, $1.33 a share; 1949, $1.36 a share; 1950, 70 cents a share; 1951, 52 cents a share; 1952, 90 cents a share; 1953, $1.15 a share; and 1954, $1.33 a share.

* * *

(385) RECROSS EXAMINATION

By Mr. Wahrenbrock:

* * *

(388) Q. If the Georgia Power Company contract had contained a provision permitting Georgia, we will say, on thirty months' notice to cancel its obligation to take and pay for the power, could the Generating Company have financed the two unit plant on as favorable terms as it did?

A. There would have been a slight difference in my opinion, unfavorable.

Exhibit 5

DIRECT TESTIMONY OF F. R. McMEEKIN

Q. Will you please state your name, address and occupation and the duties connected therewith.

A. F. R. McMeekin, 328 Main Street, Columbia, South Carolina. I am Vice President in Charge of Operations of the South Carolina Electric & Gas Company and Vice President and Director of its two wholly owned subsidiaries, South Carolina Generating Company and South Carolina Natural Gas Company. I am the responsible head of the Operating Department of the above named companies.

Q. What is your educational background?

A. After graduating from the public schools of Columbia, South Carolina, I attended Clemson College at Clemson, South Carolina and graduated therefrom in 1923, with a B.S. in Electrical Engineering.

Q. Are you a member of any engineering organizations?

A. Yes, I am a member of the American Institute of Electrical Engineers and the South Carolina Society of Engineers.

Q. Will you please describe your previous business experience.

A. Upon graduation from Clemson College in 1923, I was employed by Westinghouse Electric Corporation, at its East Pittsburg Plant, as a Test Engineer. In 1925 I joined the now South Carolina Electric & Gas Company as a Power Dispatcher. I then successively occupied the position of Chief Dispatcher, Superintendent of Transmission, Electrical Engineer, Superintendent of Power, Operating Manager and, in 1952, was made Vice President in Charge of Operations, the position which I now hold.

Q. Mr. McMeekin, what is your present connection with the South Carolina Generating Company?

A. As stated above, I am Vice President and Director of the South Carolina Generating Company, which is a wholly owned subsidiary of the South Carolina Electric & Gas Company. The South Carolina Generating Company will be sometimes hereinafter referred to as the "Generating Company."

Q. What was your responsibility in leading up to and the signing of the contract between the Georgia Power Company and the Generating Company?

A. In my duties as Manager of Operations of the South Carolina Electric & Gas Company, I participated in all discussions leading up to the contract in question between the Georgia Power Company (sometimes hereinafter referred to as the "Georgia Company") and the Generating Company. When the Generating Company was chartered, I was made President and Director and occupied this position at the time the contract in question was signed.

Q. Mr. McMeekin, will you supply background information as to the circumstances surrounding the negotiation of the power contract between the Generating Company and the

Georgia Company, especially as to the significance of the entry of Generating Company's negotiations with the Atomic Energy Commission and the results thereof. In this connection, please describe the special type of financing employed to construct the plant in question including the creation of a separate corporation.

A. In common with other electric utilities experiencing phenomenal growth in the post-war period, South Carolina Electric & Gas Company had been faced with the necessity of adding frequently to its generating capacity; in view of this condition, it had on order a turbo-generator unit, boiler and other plant equipment, the size unfixed, delivery of the unit being scheduled for August, 1952. Several sites for this proposed plant had been under consideration. With substantial steam electric facilities in the north and southeast extremities of its system, it had become apparent that the next such facilities should be located in the west-central area and extensive location studies had been made by the midsummer of 1950. Special consideration was given to a site near Branchville, South Carolina, since this location was particularly well suited for the South Carolina Electric & Gas Company's system and would result in minimum transmission loss. However, before definite site determination had been made, an announcement was made by A.E.C. that it expected to locate an enormous Hydrogen Bomb Project in the territory served by the Company, about fifty miles west of the Branchville site. Early in December, 1950, representatives of duPont Company, prime contractors for the Savannah River Project of A.E.C., contacted Electric & Gas officials in regard to construction and operating power supply for the Savannah River Project. They were advised that Electric & Gas then had on order a turbo-generator unit, and that it would build a plant of sufficient size to supply all of the A.E.C. power requirements.

Q. Mr. McMeekin, will you state whether or not you were actively engaged in a discussion with the duPont representatives concerning the possibility of evolving a contract for the power supply for the A.E.C. Svannah River Project.

A. I was, and from the outset of such discussions I was assigned the task of developing a satisfactory rate for such

power supply. On January 13, 1951, duPont was given an initial proposal for its operating power requirements.

Q. What was the reaction of the duPont representatives to the initial proposal insofar as rates quoted?

A. The duPont people indicated that the quoted rates were too high and that they were looking into other possible supplies, including the possibility of supplying all such requirements from their own plants. It was also sensed by *the* Company's representatives that the negotiations with duPont were being somewhat colored by arrangements *which* A.E.C. was making with Electric Energy, Inc. for its power supply at Paducah, Kentucky, and that a very important factor in the Paduch rate had been brought about by special financing for that project in which the ratio of debt to total capitalization was approximately 95%.

Q. What action resulted from the conferences with the duPont people?

A. We were advised by Mr. Costello, Executive Vice President and chief financial officer of our Company, that he believed some type of special financing, such as that which had been employed by Electric Energy, Inc., might be arranged to enable the Company to supply A.E.C.'s Savannah River Project power requirements on a favorable cost basis.

Q. Were studies made of such a financing approach, and if so, what were the results of these studies?

A. Yes, such studies were made. These indicated that with special financing a much more attractive proposition could be made for A.E.C.'s power supply. Accordingly, the Company submitted a proposition containing a rate based on special financing; this was satisfactory to duPont and resulted in the execution of a contract for a supply of power by Generating Company to the A.E.C. Savannah River Project.

Q. Mr. McMeekin, what brought about the negotiations with the Georgia Company which resulted in the power contract between that Company and the Generating Company?

A. The Georgia Company had become aware of our plans to construct a plant adjacent to the Savannah River Project Area and of the type of anticipated financing. Georgia Company officials advised representatives of Electric & Gas that they were contemplating the construction of a one unit

steam station near Augusta, and that they then had on order a 60/66 MW unit for use at that station. Consequently, it was suggested that a cost study be made, considering the feasibility of some arrangement whereby Georgia could secure its required capacity for the Augusta area from the Generating Company station, rather than construct its own plant, inasmuch as it appeared that with the special financing available to the Generating Company, a considerable saving would be available to Georgia Company.

Q. Mr. McMeekin, please explain methods used in determining economies resulting from the first two units of this specially financed plant, and indicate the savings to Georgia Company which presumably impelled Georgia Company to enter into the contract here under consideration.

A. In order to determine the overall economics of the two conditions and the possible saving to Georgia Company, under the two conditions, it was necessary to compare the plant cost and other cost factors under the two different propositions, that is, the plant as Georgia Company would have to finance it, and the plant as Generating Company planned to finance it. Estimated plant costs on these two bases were prepared by Gilbert Associates, Inc., engineering consultants for Generating Company, and by Southern Services, Inc., engineering consultants for Georgia Company. In general, these estimates were in fairly close agreement. Several meetings between the Georgia Company and its enginering representatives and the Generating Company and its engineering representatives were held during the spring of 1951 to resolve the differences in the estimates. Georgia representatives agreed to proceed with the cost comparison as based on Gilbert's estimate, increased by 15% to cover engineering interest, overhead and escalation. All other cost factors, such as cost of money, taxes, and operating expenses, etc. were discussed and accepted by both parties and an overall cost comparison was worked out and agreed upon.

Since these cost studies indicated large savings in favor of the common plant, Georgia representatives stated that they would be willing to enter into a purchase power contract, provided an greement could be reached as to an equitable split in the indicated savings.

Q. Please explain methods followed, and negotiations by which agreement was reached, as to charges to Georgia Company.

A. It was generally agreed that an equitable split in savings between the two costs would be the proper approach. It was the opinion of the representatives of both parties that a more equitable contract could be written if the contract were based on a two-part rate, namely, demand and energy. The demand charge was to be based on estimated plant cost and other fixed charges, including operating labor, with proper escalation provisions, and the energy charge was to be based on actual fuel and maintenance cost. After much negotiation and taking into consideration other factors, it was finally agreed that a capacity charge of $22.50 per KW per annum, based on the then estimated plant and other operating costs, would be an equitable one; this resulted in an estimated savings to Georgia in capacity cost of $5.38 per KW per annum, or a total annual saving of $403,500.

Q. Mr. McMeekin, you mentioned other factors considered which affected the capacity charges. What were some of these factors?

A. It was agreed that Georgia would obtain 75,000 KW on the high side of the station step-up transformer bank and since the guaranteed rating of the turbo-generator was 75,000 KW at its 13.2 KV terminal, the agreement to deliver 75,000 KW net to Georgia on the 115 KV side of the station step-up transformers represented a considerable concession. Station auxiliary and transformer losses normally run in the order of six to seven percent. Consequently, had the turbo-generator only produced manufacturer's rating, the then estimated cost per net KW per year would have been $16.30 under Generating Company's plan and $30.00 under Georgia's Plan, which would have resulted in a saving to Georgia of $7.50 per KW per annum, rather than the $5.38 mentioned above. It should be borne in mind that this situation regarding delivery of Georgia's share, as determined by 115 KV metering, also exists at times when there is a reduction in available capacity due to equipment outage. Consequently, Georgia's share is greater by the transformer losses under such conditions. These losses amount to approximately 458 KW under full load conditions.

Q. Are there any other benefits or savings, other than those above mentioned, resulting to Georgia in its contract, as compared to conditions under its own one unit station?

A. Yes, there are several:

1. The overall efficiency of this plant is approximately 10% higher than that proposed by Georgia. Consequently, fuel consumed per KWH is approximately 10% less.
2. No fuel tax applicable as contrasted to a three percent tax on fuel burned in Georgia.
3. If Georgia Company had constructed a one unit station at Augusta, as they proposed, they would have suffered a 100% loss in capacity, with its attendant voltage troubles in the event of an outage of this unit, whereas under the contract with Generating Company, they have only 50% loss in event of outage of one unit and it would be very improbable that they would ever suffer 100% loss of capacity.
4. Reduction in maintenance cost due to maintenance allocation being on a kilowatt-hour basis produced is another saving. Since the plant production is considerably higher than that proposed on the Georgia plant, the unit maintenance cost will be correspondingly lower.
5. Under the Georgia ownership plan, it would have been necessary for Georgia to maintain minimum load requirements during certain off peak hours when it would not have been economical for them to do so, whereas under the Generating Company contract they are allowed to reduce their take below minimum load requirements on steam units provided other loads on steam units are sufficient to make up this deficit. This factor has proven of considerable advantage to Georgia.

Q. Mr. McMeekin, what is your estimate of the annual saving to Georgia resulting from fuel and maintenance saving under the Generating Company plan?

A. Based on present day fuel cost and present load factors of the Georgia load, it is estimated that the savings accruing to Georgia would be in the order of $175,000 to $200,000 annually. This is in addition to the savings of approximately $403,000 per annum in capacity cost.

Q. Under the terms of the Georgia contract, does the Generating Company give credit to the Georgia Company for plant cost chargeable against future expansion?

A. Yes, under the terms of the contract, it was agreed that if the Generating Company installed additional capacity at the Urquhart Station, the plant cost of the station, on which the Georgia Company is charged, would be reduced by $200,000, becoming effective at the beginning of the first month following the month in which additional capacity is ready for commercial operation.

Q. What voluntary action has the Generating Company taken in respect to this provision?

A. Further studies by Generating Company indicated that the amount credited to future extensions would be raised to $581,000 and Generating Company volunteered further to make adjustment in this allowance from the initial billing date rather than defer such adjustment until the actual commercial operating date of the additional capacity, which now appears will be some time in the latter part of 1955. In other words, the Generating Company has not only voluntarily increased their allowance for future expansion but allowed such credit to start approximately two years prior to the date covered under the agreement.

Q. What would have been the situation in regard to like expenditures for future plant expansion had Georgia Company built its own plant?

A. It is reasonable to assume that Georgia would have made expenditures for future plant expansion, which cost they would have had to have borne in addition to cost strictly allocable to the first unit. These costs were not included in cost comparison shown in Exhibit 4.

Q. What has happened to Generating equipment, construction, and other cost factors since 1951, the date at which the Georgia contract was negotiated?

A. All construction costs and other costs have risen.

Q. How much has the increase in plant investment cost, and other cost factors affecting Generating costs, been since 1951?

A. Insofar as the Urquhart Station of the Generating Company, this increase has amounted to something above 15%.

Q. Would it be fair to assume that the same cost factors would have affected the cost of the proposed Georgia plant, had it been constructed?

A. Yes.

Q. What has been the affect of these increases on the cost to Georgia on its contract with Generating Company?

A. Assuming that 15%, even though it actually has been slightly higher than this, the increase in cost to Georgia would have been $2.30 per KW per annum.

Q. What would have been the amount of the increase if the same 15% was applied to the 1951 estimated Georgia plant cost?

A. This would have resulted in an increase of $1.18 per KW per annum.

Q. What would have been the additional indicated saving resulting from the Georgia contract with the Generating Company?

A. $1.88, which, added to the original 1951 indicated saving of $5.38, would make a total indicated saving as of 1955 of $7.26 per KW per annum.

Q. Were there any factors detrimental to the parent company, Electric & Gas Company, which were brought about by the contract with Georgia?

A. Yes, the most serious being that the control and regulation of flow of energy from the Urquhart Station into the Georgia system is the responsibility of the Generating Company and, in turn, the Electric & Gas Company. This difficulty and responsibility necessitated the isolation of equipment serving Georgia since phase angle difficulties exist during deliveries by Electric & Gas to Duke Power Company or Carolina Power & Light Company. In order to overcome the power flow control difficulty, the Generating Company must either isolate a unit on Georgia, or Electric & Gas must isolate a portion of its system from its other interconnections. Therefore, when one of the Generating Company's units is out of service, Electric & Gas must either lose its share of capacity from the Generating Company or split its system at another point, thereby losing capacity and operating economies at its other stations. Electric & Gas must either continue to suffer the losses brought about by such operations, or, to overcome this condition, it will be neces-

sary to install phase shifting equipment at an estimated investment cost of $600,000. This phase shifting equipment would consume approximately 375 kilowatts of power. Therefore, the total annual investment maintenance, and operating cost would exceed $100,000.

Q. You previously stated that the Generating Company type of financing was basically brought about in order to supply A.E.C. with its outside power requirements at the lowest possible cost. Is that correct?

A. Yes.

Q. In order to secure the A.E.C. contract, was it necessary for the parent company, Electric & Gas, to make certain burdensome commitments, thereby to enjoy the benefits from the construction of the Generating Company's station, the cost of such burden reducing the value of the contract between it and the Generating Company?

A. Yes.

Q. Will you outline some of these adverse factors.

A. 1. It was necessary for the Electric & Gas to make certain improvements in its transmission system so that service to A.E.C. would be of unusually high quality.

2. It was necessary for Electric & Gas to guarantee deliveries to A.E.C. under certain conditions. In case of an outage of one unit, such guarantee would result in an 83% loss of its contracted for capacity, of 45,000 KW, whereas such a one-unit outage would result in only 50% loss for the Georgia Power Company.

3. It is also the obligation of the Electric & Gas to continue to supply the Generating Company's commitments to A.E.C. in event of outage of both units' other than that of a force majeure type of outage. Under this commitment, Electric & Gas not only suffers 100% loss in its contracted for capacity with the Generating Company but also is committed to furnish 30,000 kilowatts of capacity to A.E.C.

Exhibit 2

DIRECT TESTIMONY OF W. J. READY

Q. Please state your name, address and occupation.

A. My name is W. J. Ready, and I am Controller of the South Carolina Electric & Gas Company ("Electric & Gas") and its wholly-owned subsidiary, South Carolina Generating Company ("Generating Company"), respondent in this case. My office is at 328 Main Street, Columbia, South Carolina.

Q. How long have you occupied these positions?

A. I have been Controller of Electric & Gas since 1943, and Controller of Generating Company since shortly after its inception in 1951. Practically all of my professional career over many years has been one connected with public utilities.

Q. What is your professional education?

A. I am a graduate of the University of South Carolina in the class of 1923 with an A.B. degree in economics. I am a certified public accountant, and a member of the American Institute of Accountants, and the South Carolina Association of C.P.A.'s.

Q. Are you familiar with the contract here under consideration?

A. I am indeed very familiar with this agreement. I supervised practically all of the accounting studies made in connection with the Generating Company and its Urquhart Station, as well as the studies made on this contract. I was a member of the committee which negotiated this agreement.

Q. Tell us whether or not you are familiar with the two statements filed as exhibits 1 and 2 to respondent's answer in this matter dated January 15, 1955.

A. I am.

Q. Briefly discuss the basis of the statements.

A. These two statements identified as exhibits 1 and 2 reflected projections of costs to serve Georgia Power Company and revenues from Georgia Power Company for the 25-year term of the contract. Both statements were necessarily based upon estimates of plant costs, expenses, taxes and other factors.

It may be helpful in interpreting those statements if we start with a brief resumé of the contract terms and then touch upon some of the items such as taxes which required special handling in the statements.

The base rate of the power contract to Georgia Power Company, by which I mean the charges other than the 87.20 component which is under review in these proceedings, is designed to cover the costs of rendering the service, including components for financing, fixed operations, and energy. The term "cost" as contemplated by the parties to the contract has reference to the outlays necessary to do the job rather than the term as it may be used in an accounting sense.

Q. Describe for us the finance component of the contract capacity charge.

A. The finance component of the capacity charge is designed to service the debt and the equity investment to serve Georgia Power Company. The rate was derived on the basis of 90% debt capital and 10% equity capital, with level annual charges sufficient to provide interest on and amortization of the assumed 90% debt in 25 years and a return of 8% on the assumed 10% equity. The sum of these produced a factor of 6.46%, which, applied to the then estimated total cost of $21,100,000, including $1,000,000 for working capital, resulted in a level annual cost which was rounded out to $10.50 per kw and subjected to an escalation formula for variations between the estimate and the actual investment.

An estimated total initial plant cost of $27,671,900 was used in the statements filed with the Commission on January 15 previously referred to and the Company has more recently established a figure of $27,573,700 for this purpose.

Q. What is the operations component of the contract capacity charge?

A. This component is designed to cover operating, general and administrative expenses and taxes other than such items as are included in the energy charge. Taxes on income are included in the operations component and I would prefer to discuss them separately. The operations component was originally estimated at $1.80 per kw, based upon then estimated expenses and taxes of $720,000 per annum, subject to escalation for variations from actual. Estimated expenses

and taxes of $901,392 ($6.05 per kw year) for the partial 1954 period were used in arriving at the revenues of $428,930 used in Statement No. 2, which is the projection of revenues filed with the Commission and referred to at the beginning of this testimony. This total has subsequently been determined to be $896,263 ($6.02 per kw year), producing revenues of $426,641.

Q. What energy charge is provided for in the agreement?

A. The energy charge includes the cost of fuel, maintenance, and related taxes and is increased by the average of such costs per kilowatt-hour. Statement No. 2, which is the revenue projection filed with the commission previously referred to, shows for the partial year 1954 an estimated energy charge of $801,824 for 255,351,000 kilowatt-hours, or an average of $.00315 per kilowatt-hour, whereas the actual amount has subsequently been determined to be $.00316 per kilowatt-hour.

Q. Tell us whether or not there is any additional capacity charge in this contract.

A. There is

Q. Please elaborate on this.

A. The contract provides for an additional capacity charge of $7.20 per kw which is not related to any costs to be found on the books of South Carolina Generating Company. This amount was negotiated as a sharing between Generating Company and the Georgia Company of substantial economies estimated as accruing to the Georgia Company under the contract as compared with the construction and operation of a generating station of its own. These substantial savings are primarily attributable to the assumed 90% debt financing from which Georgia derived the benefit, and it should be borne in mind that the parent company, if we brush aside the artificialities of corporate entity, is actually the vendor which financed this project and in so doing the parent had to provide equity leverage for this debt. In other words, there are costs on the books of the parent company which should be taken into account in addition to the costs to be found on the books of Generating Company, and these costs may be roughly measured by the spread between the cost of servicing equity capital and the average cost of servicing total capital to the extent that capital funds of the par-

ent company had to be provided exclusively from equity to provide such leverage.

Q. Tell us whether or not the contract provides a special formula for the determination of taxes on income as related to billing in the operations component.

A. It does.

Q. Please describe this.

A. Basically, such taxes are those which relate to the concept of income employed in the contract. In other words, if the tax is on net income with interest allowable as a deduction, the amount to be billed for such tax would be the amount of the required revenues, which, after the deduction of the tax, would leave the 8% on the assumed 10% equity capital. In order to achieve this, the contract provides for the substitution of the interest element of the finance component as the deductible interest, and the substitution of the amortization element of the finance component as the deduction for depreciation. These substitutions would only be made in case interest and/or depreciation are deductible items for purposes of computing the tax under consideration. Thus, it is apparent that an election to adopt accelerated amortization for tax purposes, or to refinance, or an acceleration in retirement of debt, will have no effect on the billing for taxes. Other technical provisions are included to assure conformity with these principles. Any tax on income arising from the payment by the Georgia Company of the $7.20 per kw additional capacity charge would not be passed on to the Georgia Company.

Q. Tell us how this matter was handled in the cost statement.

A. The computation of taxes on income included in the projection of the cost to serve the Georgia Company, which is Statement No. 1 filed with the Commission on January 15, 1955, is related to the assumed 6% return on the net investment. For this purpose it was assumed that the deduction for interest would not be the amount of interest to be paid by Generating Company, but would be the interest payable by Generating Company if its debt were 50% of its capitalization, consistent with capitalization ratios implicit in the 6% return. As alluded to previously in the discussion of the additional capacity charge, the dislocation in the capital struc-

ture of the parent company will have resulted in a disproportionately high equity ratio with a correspondingly low debt ratio and the loss of interest deductions in computing its income tax, to the extent of the difference between actual interest of Generating Company and the interest used in computing the tax element in its cost to serve. The result is essentially the *system* tax.

Q. State whether or not Generating Company holds any Certificates of Necessity in connection with the first two units at the Urquhart Station permitting what is commonly referred to as accelerated amortization.

A. It does hold such a certificate.

Q. Briefly describe this certificate and tell us whether or not it has any effect on billing.

A. Generating Company holds a Certificate of Necessity permitting it for tax purposes to amortize over a period of 60 months approximately $11,500,000 of facility costs for Units 1 and 2 at the Urquhart Station. As previously indicated in the discussion of taxes on income, the Georgia contract does not contemplate any effect upon billing as a result of a decision to obtain the tax deferment benefits of accelerated amortization.

Q. Now tell us how this item was handled in the cost statement.

A. In computing the taxes for inclusion in the cost to serve statement filed with the Commission, referred to previously, provisions for future taxes are included to the extent that provisions for current taxes are reduced by the estimated effect of the assumed use of accelerated amortization deductions. This, we believe, is consistent with Opinion No. 264 of the Commission to the effect that the use of accelerated amortization deductions in tax returns should not operate to affect rates, and is in reliance upon that opinion. An election with respect to the use of such deductions is not required until the filing of the tax return for the year 1955, and if such an election is made, the Company can elect to terminate its use at any time thereafter.

Q. What depreciation rate was employed in the cost statement?

A. A 3% depreciation rate has been used.

Q. Discuss this rate for us.

A. This rate does not purport to be the maximum reasonable rate for this purpose. Time may well disclose that it is inadequate. It is about one-fourth of 1% higher than the rate being recorded on the books and the rate being used by Electric & Gas for substantially similar property. However, for purposes of this proceeding, with a 25-year projection in view, it is my opinion that the hazards of infant mortality, due to the proximity of the site to the hydrogen project, and of obsolescence due to recent development in nuclear fuels, should receive more weight than are presently given from year to year on the books. It should be borne in mind that Georgia Power Company apparently regarded it as good business to contract for power at rates which amortize 90% of the cost in 25 years.

Q. Tell us whether or not the parent company made any commitments in connection with the Urquhart Station.

A. It certainly did.

Q. Elaborate on this.

A. As sponsor of the Generating Company and as one of its three power customers, Electric & Gas had made a number of very significant commitments to purchasers of project securities, vendors, and to Generating Company, which are of very great value to the latter company and of potentially great cost to Electric & Gas. Although it is difficult to assign a monetary value to these intangible contributions by the parent company, they should be given due weight, together with the more measurable costs arising from the previously mentioned displacement in capitalization ratios, in any comparison between the rate to Georgia Power Company which includes the $7.20 per kw additional capacity component and the rate to South Carolina Electric & Gas Company which does not.

Q. Please indicate some of these commitments.

A. The parent company initiated a number of major equipment orders and remained as a contracting party after Generating Company was organized.

In bond and note purchase agreements the parent company guaranteed the payment of commitment fees, if the securities were not sold.

In bond and note purchase agreements the parent company was obligated to provide any excess funds required to com-

plete the station or upon failure to do so to provide sufficient funds to redeem outstanding debt.

Under the Indenture and note purchase agreements the parent company is guarantor for the payment of principal and interest on bonds and notes until after certain earnings conditions are met for twelve consecutive months of operations.

Under bond purchase agreements the parent company agrees to make up any deficiency in insurance in the event that the station is destroyed or partially destroyed.

In the parent company's power purchase contract with Generating Company, the parent is obligated to supplement its payments for contract capacity to the extent necessary to provide an eight per cent return on Generating Company equity after expenses, taxes, interest and debt amortization.

In this power contract the parent agrees to be responsible for any contract capacity reduced or cancelled by any of the other contracting parties, and in the event of such cancellation at the request of the parent company, to pay for such capacity at the same rate as the party relinquishing same.

Under this power purchase contract the parent company is also obligated to successors or assigns of Generating Company.

Under the power contract between Generating Company and duPont, to which the parent company is a party, the parent company is obligated to supply any deficiency in electric service to duPont unless such deficiency results from force majeure.

Q. Have you prepared any figures showing, by years, a comparison between the contract return and a return on a straight 6% basis?

A. I have, and this is attached as Exhibit VI.

Q. Would you care to make any comments on this exhibit?

A. Yes, I would. You will note that considering this purely on an annual basis a 6 per cent return is not reached until 1962. On a cumulative basis this 6 per cent return is not reached until 1970.

Exhibit 3

ADDITIONAL TESTIMONY OF W. J. READY

Q. Do you have a statement showing changes in capitalization of South Carolina Electric & Gas Company and subsidiary companies during the period when the first two units at the Urquhart Station were being financed?

A. Yes, *Statement 4* (Exhibit VII) reflects changes in the capitalization of the system during the period from 1951 through 1954 on a consolidated basis and for each company.

Q. What trends does this statement show in capitalization ratios?

A. At the end of 1951 the consolidated capitalization ratios were the same as the ratios for the parent company; namely, 63.25% debt, 10.87% preferred, and 25.88% common equity. There was no subsidiary at that time. By the end of 1954 consolidated ratios were 62.83% debt, 9.40% preferred, and 27.77% common equity. It is therefore apparent that there was some improvement in the common equity ratio during the three-year period represented by the increase from 25.88% at the end of 1951 to 27.77% at the end of 1954. However, by the end of 1954 the parent company equity ratio had risen from 25.88% to 35.01% and its debt ratio had dropped from 63.25% to 52.64%.

Q. To what do you attribute the 1954 deviation between the parent company and consolidated ratios?

A. This is attributable to the necessity for the parent company to provide equity leverage for the debt capital of its subsidiaries. It was necessary for the parent company to provide funds for investment in common stock of the subsidiaries. It was also necessary for the parent company, in order to prevent a drop in the consolidated common equity ratio, to provide a disproportionate amount of its own new money requirements by the sale of equity securities or the retention of earnings. In other words, by the end of 1954 for every dollar of subsidiary capitalization there would have to be 27.77¢ of equity somewhere on the system to attain a 27.77% consolidated common equity ratio and to the extent that this 27.77¢ had not been provided by subsidiary earned surplus we must look for it on the parent company. Perhaps

the point can be more clearly made by observing that the 27.77% common equity is about 44% of the 62.83% debt ratio so that for each dollar of subsidiary debt the system had 44¢ of equity, the most of which was to be found on the books of the parent company.

Q. Would you say that this increase in parent company equity is entirely caused by the need to provide leverage for the debt on the first two units of the Urquhart Station?

A. No, the debt in connection with the third unit at the Urquhart Station and the debt in connection with the pipeline of South Carolina Natural Gas Company, were involved. However, as the debt in connection with the first two units at the Urquhart Station was in excess of $23,000,000, whereas the debt in connection with the third unit and the pipeline aggregated only about $8,000,000, it is evident that the leverage requirements of the first two units at the Urquhart Station constituted the principal cause of the disproportionate increase in parent common equity.

Q. You pointed out that the consolidated common equity ratio improved during the 1951-1954 period. Is this raising of the consolidated common equity ratio also partly responsible for the disproportionate increase in common equity of the parent company?

A. That is true only to the extent of the rise in parent company equity from 25.88% to 27.77%, but the parent company equity increase beyond the 27.77% to 35.01% was for leverage purposes.

Q. Do you have a statement which shows what percentage of the 1951 to 1954 increase in parent company capital is common equity?

A. Yes. *Statement 4 (a)* (Exhibit —) summarizes the changes in parent and system capitalization during the three-year period and shows that approximately 72% of the increase in parent company capital from 1951 through 1954 was common equity. Only about 10% was debt capital and about 18% was preferred.

Q. How do these net new money capitalization ratios for the parent company compare with the new money ratios for the system?

A. On a consolidated or total system basis the increase in common equity was about 31%, compared with 72% for

the parent company. New debt for the system was about 62%, compared with 10% for the parent company. New preferred was about 7%, compared with 18% for the company.

Q. To what then do you attribute this high equity ratio for parent company new money during this period?

A. It is very largely due to the very substantial debt financing during the same period by Generating Company.

Q. Do you have any information as to capitalization ratios of privately-owned electric utilities in the United States?

A. Yes, we have prepared *Statement 5* (Exhibit —) showing the capitalization of such companies as are classed A and B as reported by the Federal Power Commission for the years 1951, 1952 and 1953 in publications entitled "Statistics of Electric Utilities in the United States."

Q. Would you comment on the ratios shown by this statement?

A. We have computed common equity as 37.40% at the end of 1953. It was 38.28% at the end of 1952 and 37.33% at the end of 1951. Preferred ratios ranged from 13.45% to 12.77% from 1951 to 1953, and the debt ratio was 49.22% at the end of 1951, 48.68% at the end of 1952 and 49.83% at the end of 1953.

Q. Do you have any information as to the earnings of privately-owned electric utilities and the ratio of operating income to net plant in recent years?

A. Yes, on *Statement 6* (Exhibit 3) we have shown information derived from Federal Power Commission Release No. 7828 covering the earnings and plant accounts of privately-owned electric utility companies for the year 1954.

The release from which this data was derived points out that electric utility operating income for 1954 was approximately 6.2% of average net plant and was virtually unchanged from 1953. After including an estimated allowance for materials and supplies and working capital it is unlikely that the return would be less than 6%.

Q. Have you made a projection of money costs for the 25-year period covered by the Georgia contract?

A. Yes, we have made such a projection on *Statement 7* (Exhibit 3).

Q. Explain generally how this statement was developed and the money costs which it discloses.

A. We began with the total capitalization at the end of 1951 amounting to approximately $84,516,000 broken down between debt, preferred and common as previously discussed in connection with Statement 4 (Exhibit VII). This total capital is shown as increasing each year until it amounts to $138,612,000 by the end of 1954. The increase in 1955 is based on current forecasts. Thereafter the annual increase in capitalization is based upon an assumed 10.3% straight line increase from year to year. This factor was derived from a trending of actual increases occurring in net plant accounts from 1945 through 1955 as shown on the supporting *Statement 7(a)* (Exhibit 3) and is the ten year compound average increase. It might be noted that in the last six years of the period the plant account increased each year more than 10%. The supporting statement has been adjusted to exclude the portion of the investment in the first two units at the Urquhart Station devoted to the service of Georgia Power Company, as we were attempting to measure growth for territorial service only.

Q. Explain the method used to allocate growth capital requirements between debt, preferred and common categories on Statement 7.

A. From 1951 through 1954 the allocation is actual. For 1955 it follows current estimates. For subsequent years it is designed to gradually elevate the consolidated equity ratio to 35% and the preferred stock ratio to 15% which results in a drop in the consolidated debt ratio to 50%. In this projection the common equity ratio reaches approximately 35% in 1960 and the preferred reaches 15% in 1961.

Q. Based on the projected growth capital and the capitalization ratios which you have mentioned, how were these used to arrive at the annual cost of money for the years shown on the statement?

A. For each year shown, the total annual finance cost is the sum of the annual costs shown for debt, preferred and common. In the case of debt, the 1954 annual cost is based on actual rates for growth capital in use during that year. Beginning in 1955 we have assumed that the rate for additional new money will be 3.625%. In the case of preferred, the

actual cost has been used for 1954 and the rate for subsequent years' additional preferred after 1955 is assumed to be 4.60%. In the case of common we have assumed a cost of 10% per annum. The weighting for future years' additions is based on the assumption that the increment each year will be utilized on an average for only six months.

Q. What is the significance of the tax columns on this statement?

A. The tax columns are provided to show the taxes on income which correspond to the annual cost shown for each category of capitalization. The state tax rate is 4½% and the Federal tax rate is 52%. The state tax does not recognize interest as a deduction. The state tax is deductible in arriving at Federal taxable income. The factors shown are pyramided to include the tax arising from the collection of revenues to provide for payment of income taxes. In other words, the taxes shown are the amounts which added to the annual finance cost will, after the deduction of taxes, leave the annual finance cost as a remainder.

Q. What is the range of weighted total annual finance rates in terms of percentages of capital?

A. The 1954 finance rate or cost of money shown on the statement is 5.6794% and the corresponding tax factor is 3.6869%. Weighted finance rates range upward to a peak of 6.3536% in 1961 at which time the corresponding tax factor is 5.6207%.

Q. You have previously referred to Statement 7(a) showing ten year growth in net plant investment for the South Carolina Electric & Gas Company system in support of your growth assumptions on Statement 7. Do you have any other support for the assumptions used in Statement 7?

A. Yes, in addition to Statement 7(a) which shows the ten year growth trend in net plant we have prepared *Statement 7(b)* (Exhibit 3) which shows for the 1945 to the 1954 period the trend in sales of electricity to ultimate consumers. The annual percentage increases on this statement are even more impressive than the annual increases in net plant, being above 10% in all but two of the nine years and averaging in the neighborhood of 12% per annum.

Q. In Statement 7 and supporting statements you have been dealing with the cost of money to the South Carolina

Electric & Gas Company system rather than to South Carolina Generating Company. Do you have any statement which demonstrates the relationships between system finance costs and finance costs which are related to and chargeable against the first two units at the Urquhart Station?

A. *Statement 7(c)* (Exhibit 3) entitled "Segregation of System Capital and Related Annual Costs Between the First Two Units at Urquhart Station and the Remainder of the System" is designed to demonstrate why the weighted average system cost of money, rather than the cost to be found on the books of the Generating Company, is the proper measure of the costs to the system in connection with the two unit project at the Urquhart Station. For this purpose we have taken the year 1961 as representative. The statement is divided into four sections, the first section showing the system growth capital in use during 1961, the cost of which including related taxes is 11.9743%. The second section shows the capitalization of Generating Company in that year applicable to the first two units at the Urquhart Station. Due to the preponderance of debt, the average cost on the basis of capital ratios to be found on the books of the Generating Company is 9.1868%. The third section is headed "Displacement" and refers to parent company capital which is displaced, or out of its normal capitalization ratio position, if we consider the system capitalization ratios as normal for that year, due to the necessity of providing leverage for the capital of the Generating Company in connection with the first two units. The fourth section entitled "Non-project" represents system capital which is unaffected by the project financing. Thus the statement shows system growth capital of approximately $178,000,000, project capital of about $23,000,000, non-project capital of about $140,000,000 and approximately $14,000,000 of capital in limbo, that is, occupying temporarily an in-between status wherein the money is actually used for non-project purposes, but its cost is abnormal due to the influence of project financing. Therefore, we have allocated a part of the annual cost to the project and a part to non-project use. The amount allocated to non-project use is the normal or average system cost of such capital measured by applying the average system rate to the total dollars. The remainder, which amounts to $650,000, is the

excess of cost for such capital arising from project financing. This is the detriment to be found in the costs of parent company capital and we have applied this amount as an additional cost for units 1 and 2. The result of adding $650,000 to the $2,142,000 of cost previously determined results in a total of $2,792,000 of system costs for Generating Company capitalization for units 1 and 2 for the year 1961, resulting in a composite rate of 11.9744% which is substantially the system rate, the minor difference being obviously due to dropping fractions. If we apply this rate to the rate base applicable to Georgia, we have a return and related tax of $1,324,452. Page 2 of Statement 7(c) makes a similar determination for the year 1954.

Q. Do you contend that the cost of money is the measure of the rate of return reasonably allowable in connection with the service to Georgia Company?

A. Not necessarily, as there are other costs which should be considered, including those imposed upon the parent company of an intangible nature such as its acceptance of risks and obligations to accomplish the financing. These should be taken into account and would justify a return somewhat above the bare cost of money. Obviously the cost of money establishes a minimum requirement.

Q. Have you applied these money costs to the rate base to serve Georgia and established costs for comparison with revenues under the contract?

A. *Statement 8* (Exhibit 3) has been prepared for this purpose. It is simply a substitution of required return and related taxes at the system costs of money developed on Statement 7 in lieu of the 6% rate of return and related taxes shown on Statement 1 which has been identified as Exhibit I. It was necessary to develop depreciation, operating expenses and other taxes for intervening years not shown on Statement 1 and this is reflected on *Statement 8(a)* (Exhibit 3).

Q. On Statement 3 which is Exhibit VI you presented a comparison between cost to serve on the 6% basis and contract revenue. Have you developed a similar statement comparing the cost to serve on the projected actual money cost basis with contract revenues?

A. Yes, this is done on *Statement 9* (Exhibit 3).

Q. Please discuss the results shown on Statement 9 in relationship to the results shown on Statement 3.

A. As previously stated with reference to Statement 3, contract revenues are not sufficient to cover 6% costs until 1962, and, on a cumulative basis, the deficiency in recovery of 6% costs is not made up until 1970. The results on Statement 9 are not materially different, as that statement shows that contract revenues are not sufficient to cover system costs on the projected actual finance cost basis until 1964, and the accumulated deficiency of revenues under costs on the projected actual finance cost basis is not covered by contract revenues until 1971.

Q. Have you prepared a statement to demonstrate the mathematics involved in establishing the deficiencies in contract revenues below amounts required to cover necessary return and taxes on the two bases you have mentioned; namely, the 6% money cost basis, and the actual system cost of money basis?

A. *Statement 10* (Exhibit 3) based on the year 1961 selected as typical was prepared for this purpose. You will note that the deficiency of $29,698 in return and taxes shown on the line 8 for the 6% cost basis, agrees with the rounded out figure of $30,000 deficiency appearing on Statement 3 and that the deficiency of $133,744 shown on line 8 on the actual projected cost basis, agrees with the rounded out figure of $134,000 shown for 1961 on Statement 9.

Q. Have you prepared earnings statements to demonstrate the effect of the assumed returns and taxes shown on Statement 10?

A. Yes, *Statement 11* (Exhibit 3) reflects the taxes, the over-all return and the equity return for each of the columns appearing on Statement 10. It also proves the soundness of the tax figures.

Statement 4(a)

SOUTH CAROLINA ELECTRIC & GAS COMPANY AND SUBSIDIARY COMPANIES

Summary of Changes in Capitalization (1) 1951—1954

CHANGES
(Thousands of Dollars)

	1952	1953	1954	Totals	Ratios
Parent					
Debt	$ (930)	$ 3,657	$ (662)	$ 2,065	9.85%
Preferred	(75)	(75)	3,990	3,840	18.32
Common	4,865	5,443	4,749	15,057	71.83
Totals	$ 3,860	$ 9,025	$ 8,077	$ 20,962	100.00%
Consolidated (System)					
Debt	$ 10,110	$ 19,617	$ 3,912	$ 33,639	62.18%
Preferred	(75)	(75)	3,990	3,840	7.10
Common	4,937	5,664	6,616	16,617	30.72
Totals	$ 14,972	$ 25,206	$ 13,918	$ 54,096	100.00%

(1) Condensed from Statement 4 (Exhibit VII).

WJR/OSW
4-15-55

CROSS-EXAMINATION OF MR. W. J. READY

(597) By Mr. Wahrenbrock:

• • •

(636) Q. By external, did you have in mind bombing or other enemy action on the one hand, or some catastrophe originating in connection with the particular activity carried on in the AEC's Savannah River project?

A. Mr. Wahrenbrock, I don't want to be put in the position of reflecting on the judgment or wisdom of the powers that placed a project of that sort in our midst. It is perhaps due largely to the lay attitude towards the term "nuclear reaction", but with that qualification, I would say that (637) it seemed to me, in common with others of my associates, that the nearness of the Savannah River project of the AEC constituted more than a normal hazard, both by reason of the hazards of bombing and other hazards that might possibly occur in the handling of nuclear materials.

I admit I am not a scientist, and I am not in a position to say what protective steps have been taken by AEC to prevent anything of that sort.

• • •

(650) But in this case particularly the equity funds on which interest was capitalized came from the parent company and almost necessarily came from the equity component of the parent's capital.

• • •

Of the funds received by the parent company from outside sources, the timing of the debt money and the timing of the preferred new capital coming into the hands of the parent company is such that it is most unlikely that any significant amount of it—if any at all—could have been utilized in the construction of this project.

• • •

(651) I think we were influenced also by the fact that in the contract 8 percent was specified as the return on equity during the operating period; and there seemed to us to be no (652) less risk during the construction period than during the operating period.

• • •

(670) Q. The importance of these contracts and the negotiation of these contracts to the enterprise, to (671) which I believe you did refer, didn't rise to that level. Is that true?

A. I think I said that the organization of the company grew out of and was related inextricably to the negotiation of the contracts. In other words, as the contracts were negotiated, it became evident that the means to be employed was the separate company.

The initial negotiations were conducted possibly in the name of Electric and Gas, but as far as the construction of the plant resting exclusively on any one or more of the contracts, I don't recall having expressed an opinion on it.

Q. The negotiation of the contract with the Georgia Power Company was not so related to the organization of the company that without those negotiations, Generating Company would not have been organized. Is that true?

• • •

A. I think I will have to agree that that double negative is correct, that the company would have been created, irrespective of whether Georgia took power or not.

* * *

(726) Q. Now, aside from the costs which Electric and Gas incurs in backing up the service that Generating Company renders to duPont, does Electric and Gas incur any costs in the accounting sense which are not reflected in the base charges Generating Company makes to its three customers?

A. Yes.

Q. What are those costs to Electric and Gas?

A. Well, they may be roughly divided into two categories. One is the effect of the capital structure dislocation on the parent company, and the other is the guarantees which the parent has involved itself in.

* * *

Q. Now, your first category. I didn't understand what you meant by "the effect of capital structure at this location."

A. Dislocation

* * *

(727) A. By that I meant that the 90 percent debt on the part of the subsidiary would tend to prevent the issue of debt on the parent for its new money requirements if the parent was to maintain or gradually improve the equity ratio.

Q. Yes, I understand. You testified to that in your direct testimony. Now, would you say that that is a cost which, as far as it is a cost in an accounting sense, is part of the cost of capital?

A. Part of it is cost of capital and part of it is the tax that goes with the cost of capital.

Q. The tax effect that you have just referred to would be the effect of reducing tax costs; is that right?

A. No, the tax effect would be an increase in cost to the parent company because if a high proportion of equity is issued on the parent as a corporation, a low proportion of debt, which was true during 1951 through 1954, the parent would have less interest to deduct on its tax return and would have

to pay substantially higher income taxes than it would have if it had a lower equity and a higher debt.

* * *

(728) Q. Well, then, it seems to me I may treat your tax effect as being dependent upon the same factors as relate to the cost of capital?

A. I think so.

Q. Now, as I read your testimony on this subject in your direct examination, you say that the difference between the cost of servicing the equity capital and the average cost of servicing the total capital, to the extent that that capital funds of the parent had to be provided exclusively from equity, measures such costs to Electric and Gas. That appears on page four of Exhibit 2.

I think you said roughly measures. Now, does that mean the extra cost to Electric and Gas of financing through equity capitalization, rather than through lower cost debt capital, incurred to restore the system ratio to what it was previously?

A. Yes, that would be necessary in order to restore it to what it was previously, but what actually happened was it improved slightly, so to maintain it or to restore it, as you say, or to improve it, in any event, the financing of the Generating Company would operate as a drag and involve a higher proportion of equity to be issued by the parent company.

* * *

(753) Q. And, again, the risk would be the kind of risk for (754) which it would be entitled to compensation, if at all, in the return on its investment?

A. Yes.

Q. Let me ask you whether, in that connection, this risk which is incident, as I understand your statement, to the position of Electric & Gas, as the purchaser of power under the power contract, would you say that that relates to the cost of service to Georgia Power Company for the service rendered to Georgia Power Company?

A. I think it does. Our position throughout has been that this is a system cost that we are talking about and we are not so much concerned about how much is to be found on the books of one company and how much on another and

how much of it is intangible contributions that maybe you can't put your finger on in either set of books, but rather the cost to do the job and the total cost to do the job would necessitate a return to the system and no allowance for the return to the parent is included in the base charge in the contract.

* * *

(760) A. Yes; to illustrate, if the Electric and Gas issues (761) common, preferred and debt, and assuming for the sake of argument that ten per cent return is appropriate on common, and assuming also for the sake of the argument that the composite return for both common, preferred and debt would be six per cent, there would be an additional four percent required by the parent company with respect to its own dollars; that is, with respect to dollars that are used in the general service of its customers by South Carolina Electric and Gas Company, and by the same token, the income tax which arises by reason of the dividends not being deductible, the dividends on common stock not being deductible, the taxes would be higher than they would be if you had a combination of dividends and interest, and the interest were deductible for tax purposes.

Q. Now, in your next sentence you say this amount—

A. Excuse me, may I say something further, which I think bears on that, in order not to be misunderstood?

Q. Yes, certainly.

A. The reference made here to the fact that no part of the $7.20 is to be found on the books of the Generating Company, I think is perfectly true in context. Somebody has to earn or some customer has to pay, not only for the dislocation of the capital employed by the parent company, but also for the capital, the equity funds employed by the Generating Company in the first two units.

That capital was supposed to start out at ten per cent; (762) that is, ten per cent of the capital was supposed to be equity. It is actually some $600,000 above the ten per cent figure. As the debt of the subsidiary is retired, of course, the equity proportion increases, and in connection with the spread between the revenue component for amortization of

debt and the revenue deduction item of depreciation, which you mentioned this morning, there would inevitably be not only an increase in the ratio of equity on the books of the Generating Company, but actually an increase in the dollars of equity on the Generating Company during the 25-year period, to the extent of the spread between amortization revenues and depreciation deduction; or to say it another way, to the extent of the undepreciated value of the plant at the end of 25 years, with the debt paid off in full. You can see that the undepreciated value of the plant at the end of 25 years will be entirely equity because there will be no debt.

Somebody has to earn on that equity and the eight per cent on ten per cent pays not only eight on ten, but it pays it on the $2,666,000, instead of on several millions more than that, if you assume that the three per cent depreciation is the proper rate.

* * *

(769) A. At some reasonably current date. A very large segment of that capital could not have contributed to the construction of the Urquhart station or be influenced by its construction and so I would say first of all, that we should look at the growth capital, the cost of growth capital during the period of construction to get the average (770) cost of the money dedicated to that project and in addition to that, we can't ignore the future. The likelihood is that the capital ratios will be improved. There is no good reason that I can think of why Electric and Gas in its equity ratio should continue indefinitely to lag as far behind the National average equity as it is today and has been for several years. Therefore, if we face up to the probability that the ratios will approach and will ultimately equal today's National average, you will have additional common and preferred issued in the future, in lieu of debt, there will either be the issuing of common or preferred or both, and the conservative dividend policy of the company at the present time results in some accumulation of earnings for reinvestment. The effect of this new capital is going to naturally result in the requirement for earnings to support the capital and to take care of the taxes that go with that new money and it seems perfectly

proper and equitable to require the project to bear a share of the cost of the new money in the future to the extent that the low debt of the project will act as a drag, and involve the need for additional equity in order to pull the consolidated equity up.

• • •

(872) A. The six per cent return which was used on Statement 1 was developed in consistence with our position that the cost of money and the related taxes should be looked on from the system standpoint, and therefore, in certain years, at any rate, the fifty per cent capitalization would involve the use of a tax figure in excess of the tax figure to be found on the books of the Generating Company as we look into the future.

• • •

(882) A. It is my contention that for quite a good many years the revenues produced by the billing provided under the contract including the $7.20 per KW year will not exceed the cost incurred by the South Carolina Generating Company and the South Carolina Electric and Gas Company, if we include in that cost to serve a fair rate of return on the investment and the appropriate taxes to that fair rate of return. In the early years that is quite apparent from some of the exhibits that have been filed in the case. A deficiency which occurs in the first or second or third or fourth year of the 25 year term and which the utility has to wait until the 20th or 25th year to recover represents not only a dollar deficiency in return in the early years, but a deprivation of the use of those funds for a great many years, the compound interest on which would be a very substantial figure. We feel that it would be a serious problem in view of the inadequate return in the early years to take (883) precipitate action which would aggravate that deficiency merely on some return that assumes that through the regulatory process deficient returns in early years can be recovered through regulatory benevolence in later years or by allowing returns in the later years in excess of the theoretical cost produced by the usual formula.

Exhibit 6

DIRECT TESTIMONY OF J. M. COSTELLO

Q. Please state your name, address and occupation?

A. I am J. M. Costello of Columbia, S. C.; my business address is 1309 Hampton Street in that City, and I am Executive Vice President of South Carolina Electric & Gas Company (Electric & Gas), and a Vice President of its wholly owned subsidiary, South Carolina Generating Company (Generating Company).

Q. How long have you occupied this position?

A. I have been a Vice President of Electric & Gas since 1946; I became its Executive Vice President shortly thereafter. I have been a Vice President of Generating Company since shortly after its organization in 1951.

Q. Have you occupied other positions in the public utility industry?

A. Yes, I have. I have for many, many years been connected with this industry, and have served in a variety of positions with several ~~different~~ utilities.

Q. In addition to the duties normally attendant upon the office of Executive Vice President of Electric & Gas, do you exercise any other duties of a particular nature of especial interest here?

A. Yes. Before becoming Executive Vice President of Electric & Gas I was its Financial Vice President. The duties of this office entailed those normally exercised by the chief financial officer of a corporation. In this position particular emphasis was laid upon securing new funds with which to finance additions, betterments, and similar items normally attendant upon a rapidly expanding electric utility. These monies were secured chiefly through the issuance and sale of common and preferred stock and bonds. These duties I still exercise as a function of my office of Executive Vice President.

Q. Explain the basis on which Generating Company was financed.

A. This financing has followed generally the pattern pursued by Electric Energy, Inc., in securing funds with which to finance the construction of its steam electric generating

station near Paducah, Kentucky. This plant was built to supply electric capacity and energy to an installation of the United States Atomic Energy Commission (AEC) near that point.

Q. Why was this pattern followed?

A. It was particularly fitting that this method should be used here. As another witness, F. R. McMeekin, will more fully testify, AEC, acting through its prime contractor at its Savannah River Plant (SRP), E. I. duPont de Nemours and Co., approached Electric & Gas about securing power for use at the SRP. It became obvious that normal financing would not produce a plant which could sell power at a price which would sell to AEC. It was but a normal and logical step to resolve this problem in approximately the same manner it had already been worked out for AEC by Electric Energy, Inc.

Q. Why was a separate corporation formed?

A. Quite obviously Electric & Gas because of its Indenture retsrictions could not finance such a plant on the basis contemplated. Hence the formation of a separate corporation was necessary.

Q. What type of securities were used, and in what ratio, to secure the capital for the plant here in question?

A. 75% of these were mortgage bonds, 15% were ten year notes and the remaining 10% was in the form of common stock.

Q. Tell us whether or not you discussed this financing with the Securities and Exchange Commission (SEC)?

A. Yes, I did discuss the proposed issuance of securities with the staff of SEC, although no formal action was required by that Commission. The staff informed us that they would expect Electric & Gas' subsequent financing to be of a character such as would tend to reduce the impact of this high debt ratio on its capital structure.

Q. Answer whether or not Georgia Power Company (Georgia Power) indicated any interest in securing power from this new plant?

A. Indeed they did. Their representatives approached us and expressed a keen interest in securing power from this new plant—which was ultimately named Plant Urquhart—and exhibited a desire to participate in the venture.

Q. State whether or not you participated in the negotiation of the contract which resulted from this approach by Georgia Power.

A. I did.

Q. Describe these transactions.

A. These negotiations consisted of lengthy sessions spread over several months. Both sides were represented by a committee of engineers, financial men, accountants, lawyers, tax specialists, and such other personnel as might be necessitated by the problem of the moment. All problems were openly, fully, and thoroughly discussed and completely and freely negotiated upon. Frankly, I have never seen any negotiations conducted more at arm's length than these were. All during these sessions it became increasingly evident how much Georgia Power would benefit from this type of financing.

Q. Does this contract have a recapture clause or not?

A. Yes, it does.

Q. Please describe it.

A. Section 4.03 of the agreement provides for the recapture, at will, by Generating Company of not over 25,000 KW upon twelve months notice. Section 4.04 provides that all of the contract demand not already taken under Section 4.03 may be recaptured upon thirty months notice.

Q. Tell us what factors might impel Generating Company to exercise its right of recapture.

A. Barring some unforseen eventuality which would make it unfeasible for Generating Company to secure equipment in the open market or to construct new plants, such factors would, of course, be chiefly economic ones.

Q. Please enlarge on this.

A. In a system which is expanding as rapidly as ours the cost of new plants is an ever present and saliently impelling factor. When Plant Urquhart was originally constructed, only two units were ordered—each of 75,000 KW capacity. Before these were completed, a 100,000 KW unit was ordered. The first two units were completed last year (1954), and work is already well in progress on the installation of this third unit. Already plans are being formulated for the construction of still another plant to support the ever-increasing load of the system. Quite naturally this requires us to e-

sess at short intervals the cost of constructing these new plants against the return we derive from the capacity at Urquhart used by Georgia Power. When this latter amount reaches a point below the former, in the absence of some other impelling motive of which I am not currently aware, recapture will follow as a rational and normal result. And I will also say that increased costs evidenced in just the few years since this contract was executed have brought these two factors already dangerously close together.

CROSS-EXAMINATION OF MR. J. M. COSTELLO

By Mr. Wahrenbrock:

(915) Now, when did the device of a separate corporation enter into your plans?

A. Mr. Wahrenbrock, we made considerable studies at (916) the time when duPont project, or the hydrogen project was to be publicly stated to be located in South Carolina.

• • •

(916) We reviewed—or I reviewed—various programs of the possibility of financing this huge power plant, and we had considered seriously the possibility of doing it within the confines of the corporate limits of South Carolina Electric and Gas Company.

We recognized the limitations that would be imposed by using the corporate structure of South Carolina Electric and Gas Company because of the existing indenture provided for a limitation of 60 percent take-down of bonds.

• • •

Primarily because of that situation was the reason that South Carolina Generating Company was formed. In fact, If I might say at this point, that the only reason that the South Carolina Generating Company, or a subsidiary company, was formed, was because of the limitation or the restrictions imposed.

• • •

A. I would say it was the prime reason. I don't recal at the moment whether there were any other reasons, but know that the prime reason was the restriction imposed o

the indenture of South Carolina Electric and Gas Company prohibiting the issuance of bonds beyond 60 percent.

(917) So it was necessary to form a separate corporation in order to do this type of financing, recognizing full well that as far as the prospective institutions that would invest in these securities, that they would require sufficient guarantees on the part of the parent to assure that the credit of South Carolina Electric and Gas Company were back of these issues, and it wasn't relying solely on the credit or the standing of South Carolina Generating Company which was just created solely for that purpose.–

• • •

(929) Q. I don't understand, Mr. Costello, why this lower cost of financing, which is produced, which you expected to be produced, by the 90-percent debt ratio method of financing, in lieu of the conventional method of financing, is not regarded by you as a reduction of the cost of doing business.

A. I don't mean to imply that it is not a reduction in the cost of doing business in the sense that what chiefly developed by the utilization of a 90-percent debt as contrasted with the conventional 50- or 60-percent was the fact that we gained momentarily a tax advantage, that we recognize that subsequently we had to correct our capital (930) structure which necessarily meant that we had to sell more equity securities in subsequent years to correct for that situation that was produced as a result of the impact of that high debt.

We felt that the earnings that would develop from the contracts in force would enable us to make those correcting factors over a reasonable period of time.

That in the interim period, South Carolina Electric and Gas Company and the public which it was serving would have the advantage of having that huge system plant available to provide for the service and growth in our service territory.

Q. Was it your view that the 90-percent debt ratio method of financing, the use of a 90-percent debt ratio financing in lieu of a convention method of financing, would only postpone costs of doing business?

A. I did not want to confine my answer solely to that situation whatsoever. I said that one of the prime things that influenced us to take the 90-percent debt basis was that that was the only means that we could forsee that would safely permit us to develop this huge project representing $25 million in producing a power plant of 100,000 kilowatt capacity; that resorting to conventional-type financing at the time, as I recall the financial condition of the company, we did not see how we could resort to a conventional-method (931) of financing at that time to produce the plant of that capacity. That was one of the reasons that motivated us in taking and resorting to that type of financing.

Now, the secondary reason was that we realized full well that that was going to create an impact on the financial structure of South Carolina Electric and Gas Company and the equity at that time would be reduced substantially. But we realized, we felt, that the earnings that would be generated from these contracts, plus the growth in the territory because of the hydrogen plant, the combination of which would produce earnings that would enable us to sell equity securities to restore the equity position of the company to what we felt was a proper one.

The actual facts in the case are that during the period of construction, we actually sold the equity securities on the plant. As I recall, the testimony in this case shows that in producing the outside money requirements from 1951 to 1954, that some 70 percent was raised through equity money, and that bears out my contention.

* * *

(937) MR. WAHRENBROCK: I will try to make that as plain as possible, because as I regard this testimony, the witness started out with the problem he was employed by Electric and Gas, and Electric and Gas wanted to get this business, and adopted a special method of financing which included a separate corporation.

Now, for the purpose of this question, I think it is proper to regard what was done through a separate corporation as a device that was used by Electric and Gas.

Now, if we want to argue that separately, all right, but I would like to assume that for the purpose of this question.

• • •

(938) THE WITNESS: Mr. Wahrenbrock, my answers were intended to indicate that temporarily, not in the long run, that the impact of this high debt ratio would require South Carolina Electric and Gas Company to issue a greater amount of equity securities than it normally would in order to correct for that impact.

But once that was accomplished, the cost of money in the long run, as you say, would not be in excess of the conventional method of financing or the ordinary type of method as usually resorted to by a utility.

• • •

(948) PRESIDING EXAMINER: I want to go back to this business of potentiality and the possibility of normal financing to do this job. I want to be sure that I understand you on two points, because, to my mind, they are fairly critical facts.

The first is—and I want to ask this broader, and I am not going to state it the way you do; I am going to state it a little differently: Was there any method by which—any method that you knew of then, or could discover then, or even know of now—the parent company—and there wasn't a subsidiary then; there was just one company—could have financed this power (949) plant at costs low enough to attract the duPont business?

THE WITNESS: There were none. In fact, there was considerable doubt in my mind, and at the time I didn't know of any other way that we could successfully finance even at any other cost. I mean it seemed to me that there was no other feasible way.

PRESIDING EXAMINER: All right. This, then, was a tactic of necessity? You either got the duPont business by this method or you did not get it at all?

THE WITNESS: That is unquestionably true.

PRESIDING EXAMINER: That nails that fact down.

Now, the second point is this—and this is an implication; but I am trying to get it clear so I will not have to base my

appraisal later on implication solely; but it may be clearer than I think; and I am using my memory; I have not read this.

Having in mind the financial condition of the parent company, which, again, was the only company at the time, as the financial adviser, as the officer charged with raising money through securities, and knowing that financial condition, could you, regardless now of the costs resulting, successfully have financed this amount of money?

THE WITNESS: I did not believe so.

PRESIDING EXAMINER: So, it also became, from that angle, a tactic of necessity to use the subsidiary and the special 90 percent, or whatever it was, type of debt ratio financing?

(950) THE WITNESS: That was the conclusion I had reached and which I so recommended.

* * *

(972) Q. Did the nature of the Savannah River project and the relationship of the Urquhart plant to that project give rise to any difficulty in interesting Metropolitan Life in financing this plant?

A. It did, and that was one of the reasons that Metropolitan was very anxious that South Carolina Electric and Gas Company in every way would guarantee the situation in such a manner as if they were directly obligated in the first instance.

So that these insurance companies would not be dependent solely on falling back on the power plant as a source of security; that their protection would lie in the credit of South Carolina Electric and Gas Company. They well recognized (973) that South Carolina Generating Company was merely created as a vehicle to permit the financing; that it had no credit standing of its own.

Q. Did you feel that that was a factor making it difficult for you to get as cheap money as you might otherwise have gotten?

A. No. I would say this: That with the willingness on our part that South Carolina Electric and Gas would back

up this situation, that it contributed to a lower cost of money than otherwise could have been obtained.

• • •

(976) Q. Now, you spoke of Metropolitan Life's interest in the contracts for the sale of the power in connection with the financing.

What effect did the negotiations or the prospect of a negotiation of a contract with Georgia Power Company have on the negotiations with Metropolitan Life?

A. Well, when Georgia Power Company had indicated to us an interest in participating in this situation, I approached Metropolitan, as well as the other institutions, with the suggestion that we had, that we wanted to amend our original proposal so as to permit Georgia Power Company to participate.

The program as then more or less finalized was with the understanding that South Carolina Electric and Gas Company would agree that in the event that Georgia Power Company, for any reason whatsoever, would terminate the contract, that the obligation would fall on South Carolina Electric and Gas Company so that it would conform with the initial undertaking.

Furthermore, it was provided in the negotiations at (977) that time, and subsequently incorporated in the contract, that if duPont would increase their requirement from 30,000 up to 63,000, as they were then contemplating—I mean, they had a high and a low figure at that point; whether it was 30,000 or 63,000—we had provided a slot in our financing whereby we could recapture from Georgia sufficient of that capacity so that we could place it back on duPont if conditions would require.

The insurance companies were very much interested in seeing that that was provided, because it would fall back then, more or less somewhat in substance, with the original agreement.

STATEMENT OF THE CHAIRMAN OF THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

My name is Clyde F. Boland, and I am Chairman of the South Carolina Public Service Commission ("Commission").

Our Commission has regulated—and has been thoroughly familiar with the operation of—the South Carolina Electric & Gas Company; parent of the Respondent, South Carolina Generating Company, and its predecessor corporation for many years. This has been particularly true since the passage by the South Carolina General Assembly of the Public Utility Regulatory Act of 1932.

Our Commission has been kept thoroughly appraised of the plans of South Carolina Generating Company since its inception, including the contract here under consideration. We were kept thoroughly appraised of the progress of the negotiation of this contract, and of all the circumstances surrounding it. These plans were approved by our Commission, as was also true of this contract, as well as all other contracts of South Carolina Generating Company. We feel that these contracts are good contracts. We feel that the rates paid by the consumers are in all cases fair and reasonable. The contract here under consideration—as well as the rates therein—are quite obviously fair and reasonable, and represent, in our opinion, a good agreement for the affected consumers in both South Carolina and Georgia. We are at a loss to understand the reasons for this hearing.

The Federal Power Commission has stated that there is some indication that the rate in the Georgia contract is discriminatory in view of the rate in the contract between Electric & Gas and Generating Company. To begin with, we do not feel that the Federal Power Commission should compare these two contracts. It has no jurisdiction over the contract between Generating Company and Electric & Gas, that being solely within the province of the South Carolina Public Service Commission. If the Federal Power Commission should find that the Georgia contract presents a reasonable rate, but that the Electric & Gas contract is even lower than a reasonable price we fail to see how that would effect the reasonableness of the Georgia contract. However, our Commission has looked at both contracts, and do not find them to be the least bit discriminatory. Electric & Gas has performed many services for Generating Company, made many commitments for it, entered into certain guarantees for it, and has experienced a substantial impact on its own capital structure with a resultant additional burden imposed upon its own financ-

ing. We feel that the cost of these to Electric & Gas, and the value of them to Generating Company, make up for any differential enjoyed by Electric & Gas in its purchases over the price paid by Georgia Power Company in its purchases.

Further, we feel that the rate enjoyed by Georgia Power Company is reasonable. We do not believe that during the life of the contract Georgia will pay an unreasonable rate for its power. Even if we assume that at some date in the future the rate of return may be excessive, we do not feel that the Federal Power Commission should act to lower this rate until that point is reached. It is perfectly obvious that any projections as to future rates of return must be based upon assumptions, and these may never become realities. Even if we assume that at some future date the rate of return may be excessive, who knows what events may interpose themselves between the present and that future date to the extent that service may not even be rendered under the contract at that time. Hence, we strongly urge that even if a finding should result—and we do not feel that it will—that at some future date the rate of return may be excessive, that the Federal Power Commission wait until such future date to take any action in regard to the rate.

From the testimony of Respondent's witnesses it is obvious that Georgia Power Company is getting its power for considerably less than they could have gotten it by any other available means. This should be applauded as a sensible, farsighted business arrangement redounding to the interest of rate payers in both Georgia and South Carolina; not something that should be vilified.

If the contract were voided, the Georgia Power Company would have to build a new plant and power from the new plant would cost Georgia Power Company considerably more which additional cost would be passed on to the Georgia consumers thereby costing them more for service.

It seems to our Commission that any revision of these rates downward would be loading on consumers in South Carolina an unfair share of the cost in this instance. We see no warrant for such a move.

I have conferred with the Governor of South Carolina and he is of the opinion that the present contract is just and reasonable and that no change is warranted.

Exhibit Attached to Statement of Clyde F. Boland

STATE OF SOUTH CAROLINA
THE PUBLIC SERVICE COMMISSION

Columbia 1, S. C., Jan. 2, 1952.

State of South Carolina
County of Richland

Before the Public Service Commission

In Re: Application of the South Carolina Electric & Gas Company for Authority (1) to Form a Subsidiary Company (2) for the Said Subsidiary Company to Construct Facilities, and (3) for the Necessary Financing in Connection Therewith.

Order No. E-671

Docket No. 7719

To: South Carolina Electric & Gas Company, Columbia, South Carolina and South Carolina Generating Company, Columbia, South Carolina

WHEREAS, this Commission issued its Orders Nos. E-668 and E-671 on October 5, 1951 and November 20, 1951, respectively, authorizing South Carolina Electric & Gas Company, hereinafter sometimes referred to as the "Company", and South Carolina Generating Company, hereinafter sometimes referred to as the "Generating Company";

(a) As to the Generating Company:

(1) To enter into Power Contracts with the Georgia Power Company and the South Carolina Electric & Gas Company substantially similar in form and content to those attached to the Supplemental Petition of the Company and Generating Company dated October 4, 1951, as Exhibits D and E thereto, respectively; and

(2) To issue and sell to Metropolitan Life Insurance Company of New York in accordance with the terms and conditions of a Bond Purchase Agreement and an Indenture submitted with the aforesaid Supplemental Petition of October 4, 1951, as Exhibits A and C, respectively, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto and final approval for which was to be

given by an order supplemental thereto, not to exceed $16,800,000 principal amount of First Mortgage Bonds, maturing not later than 28 years from the date of the aforesaid Bond Purchase Agreement, bearing interest at the rate of 3⅞ per centum per annum, the sale price to be 100% of the principal amount thereof; and

(3) To issue and sell to Northwestern Mutual Life Insurance Company, Milwaukee, Wisconsin, in accordance with the terms and conditions of a Bond Purchase Agreement and an Indenture submitted with the aforesaid Supplemental Petition of October 4, 1951 as Exhibits A-1 and C, respectively, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto and final approval for which was to be given by an order supplemental thereto, not to exceed $3,200,000 principal amount of First Mortgage Bonds maturing not later than 28 years from the date of said Bond Purchase Agreement, bearing interest at the rate of 3⅞ per centum per annum, the sale price to be 100% of the principal amount thereof; and

(4) To issue and sell to Mellon National Bank and Trust Company, of Pittsburgh, Pa., as Trustee of sundry Trust Estates, in accordance with the terms and conditions of a Note Purchase Agreement submitted with the aforesaid Supplemental Petition of October 4, 1951, as Exhibit B, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto, and final approval of which was to be given by an order supplemental thereto, $3,000,000 principal amount of its Promissory Notes, maturing October 1, 1961 and bearing interest not in excess of 4 per centum per annum at a sale price of 100% of the principal amount thereof; and

(5) To issue and sell to Reliance Life Insurance Company of Pittsburgh, Pa., in accordance with the terms and conditions of a Note Purchase Agreement submitted with the aforesaid Supplemental Petition of October 4, 1951 as Exhibit B, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto and final approval for which

was to be given by an order supplemental thereto, $1,000,000 principal amount of its Promissory Notes, maturing October 1, 1964 and bearing interest not in excess of 4 per centum per annum at a sale price of 100% of the principal amount thereof; and

(6) To issue and sell shares of Capital Stock of said Generating Company for an aggregate consideration not in excess of $2,666,666.67 and to receive any contributions to its capital which may be made; and

(7) To enter into, execute and deliver, and to perform and carry out, all of the terms and conditions of the Bond Purchase Agreements, Note Purchase Agreements and the Indenture, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto, and final approval for which was to be given by an order supplemental thereto, all substantially in the forms of Exhibits A, A-1, B and C, respectively to the aforesaid Supplemental Petition of October 4, 1951;

(b) As to the Company:

(1) To purchase for not to exceed $2,666,666.67, shares of Capital Stock of the Generating Company, the issuance of which was authorized by paragraph (a) (6) above, and to enter into, execute and deliver, and to perform and carry out all of the terms and conditions of the Bond Purchase Agreements, Note Purchase Agreements and the Power Contract with the Generating Company, including the making of any contributions to the capital of said Generating Company contemplated therein, all substantially in the forms of Exhibits A, A-1, B and E, respectively, to the aforesaid Supplemental Petition of October 4, 1951.

WHEREAS, the Company and Generating Company have filed a Supplemental Petition dated December 27, 1951, stating that they have completed the drafting of and have entered into, executed and delivered

(a) Bond Purchase Agreements with Metropolitan Life Insurance Company and Northwestern Mutual Life Insurance Company, respectively, in the forms submitted with said Supplemental Petition of December 27, 1951, and made a

part thereof as Exhibits A and A-1, providing for the sale to said institutions, respectively, of not in excess of $16,800,000 and $3,200,000 principal amount of First Mortgage Bonds, 3⅞% Series due 1979 of Generating Company at a price of 100% of the principal amount thereof; and

(b) Note Purchase Agreements with Mellon National Bank and Trust Company, as Trustee of sundry Trust Estates, and Reliance Life Insurance Company of Pittsburgh, respectively, in the forms submitted with said Supplemental Petition of December 27, 1951 and made a part thereof as Exhibit B and B-1, providing for the sale to said institutions, respectively, of not in excess of $3,000,000 and $1,000,000 principal amount of 4% Promissory Notes due 1964 of Generating Company at a price of 100% of the principal amount thereof; and

(c) A Power Contract between themselves and The First National Bank of South Carolina of Columbia in the form submitted with said Supplemental Petition of December 27, 1951, and made a part thereof as Exhibit E; and

WHEREAS, said Supplemental Petition of December 27, 1951, also states that Generating Company has entered into, executed and delivered a Power Contract between itself, Georgia Power Company and The First National Bank of South Carolina of Columbia in the form submitted therewith and made a part thereof as Exhibit D, and

WHEREAS, said Supplemental Petition of December 27, 1951, also states that the drafting of the Bond Indenture, to secure the First Mortgage Bonds, 3⅞% Series due 1979 of the Generating Company, has been substantially completed and the Generating Company plans to execute the Bond Indenture in substantially the form submitted with said Supplemental Petition of December 27, 1951, and made a part thereof as Exhibit C; and

WHEREAS, said Supplemental Petition of December 27, 1951, also states that the Construction Agreement between Generating Company and Gilbert Associates, Inc. in the form submitted with said Supplemental Petition of December 27, 1951 and made a part thereof as Exhibit F has reached final form and the Generating Company plans to execute the Construction Agreement in substantially such form; and

NOW, THEREFORE, having carefully considered the Supplemental Petition dated December 27, 1951 and Exhibits thereto and all relevant facts, this Commission is of the opinion and so finds, that:

(1) The proposed financing program, as set forth in Supplemental Petition dated December 27, 1951, together with Exhibits A, A-1, B, B-1 and C to said Supplemental Petition and the funds expected to be obtained thereby are necessary and proper for the purposes for which they are to be used and the securities planned to be issued are of the kind and type most advantageous for the purposes involved; and

(2) The Power Contracts in the forms set forth as Exhibits D and E to the Supplemental Petition dated December 27, 1951, and the Construction Agreement in substantially the form set forth as Exhibit F to said Supplemental Petition dated December 27, 1951, are or will be of the kind and type most advantageous for the purposes intended, to wit, to provide for the construction of the steam electric generating plant at Beech Island, South Carolina and the sale of power generated thereat.

WHEREFORE, in consideration of the foregoing, IT IS ORDERED, ADJUDGED AND DECREED that

(1) The actions of the Company and Generating Company in entering into, executing and delivering the Bond Purchase Agreements and the Note Purchase Agreements in the form of the four instruments submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits A, A-1, B and B-1, respectively, are ratified and approved.

(2) The Company and Generating Company are granted authority to perform and carry out all of the terms and conditions of the Bond Purchase Agreements and Note Purchase Agreements as set forth in the four instruments submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits A, A-1, B and B-1.

(3) The Generating Company is granted authority to issue and sell not in excess of $20,000,000 principal amount of its First Mortgage Bonds 3⅞% Series due 1979 in accordance with the terms and conditions set forth in the Bond

Purchase Agreements submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits A and A-1, respectively, and to issue and sell not in excess of $4,000,000 principal amount of its 4% Promissory Notes due 1964 in accordance with the terms and conditions set forth in the Note Purchase Agreements submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits B and B-1, respectively.

(4) The Generating Company is granted authority to issue and sell to the Company shares of its Capital Stock for an aggregate consideration which together with contributions to its capital heretofore made shall not exceed $2,666,666.67 and to receive from the Company any further contributions to its capital which may be made, all in accordance with the terms and conditions of, and as contemplated by, the aforesaid Bond Purchase Agreements and Note Purchase Agreements.

(5) The Company is granted authority to purchase shares of the Capital Stock of the Generating Company for an aggregate consideration which together with contributions to the capital of the Generating Company heretofore made shall not exceed $2,666,666.67 and to make any further contributions to the capital of Generating Company, all in accordance with the terms and conditions of and as contemplated by, the aforesaid Bond Purchase Agreements and Note Purchase Agreements.

(6) The action of the Generating Company in entering into, executing and delivering the Power Contract with Georgia Power Company and the First National Bank of South Carolina of Columbia in the form of the instrument submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit D are ratified and approved.

(7) The Generating Company is granted authority to perform and carry out all of the terms and conditions of the Power Contract referred to in Paragraph 6 above.

(8) The actions of the Company and the Generating Company in entering into, executing and delivering the Power Contract between themselves and the First National Bank

of South Carolina of Columbia in the form of the instrument submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit E are ratified and approved.

(9) The Company and the Generating Company are granted authority to perform and carry out all of the terms and conditions of the Power Contract referred to in Paragraph 8 above.

(10) The Generating Company is granted authority to enter into, execute and deliver and to perform and carry out all of the terms and conditions of the Bond Indenture in substantially the form submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit C.

(11) The Generating Company is granted authority to enter into, execute and deliver and to perform and carry out all of the terms and conditions of the Construction Agreement in substantially the form submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit F, and

(12) The Company and Generating Company are granted authority to do any and all other things necessary and incidental to the transactions herein referred to.

All previous orders of the Commission in this Docket No. 7719, except insofar as the provisions of any of them may be modified or changed by this order, shall remain in full force and effect; any provisions of such previous orders, or any of them, if any, which are in conflict with any of the provisions of this order, are hereby superseded by the provisions of this order.

BY ORDER OF THE COMMISSION.

/s/ J. C. DARBY, *Chairman*

ATTEST:

/s/ J. N. LAND, JR., *Secretary*

TESTIMONY SUBMITTED BY THE STAFF OF THE FEDERAL POWER COMMISSION

Exhibit 19

DIRECT TESTIMONY OF DALE E. GOUBLEMAN

Introduce rate of return study exhibit.

Q. Will you state your name?

A. My name is Dale E. Goubleman.

Q. What is your position at the present time?

A. I am a Public Utilities Specialist, Office of Chief Accountant, Federal Power Commission.

Q. Will you state your educational background?

A. I was graduated from the School of Business Administration of the University of Nebraska in June 1932 with a degree of Bachelor of Science.

Q. Will you state your experience?

A. From January 1934 to March 1937 I was employed as an Auditor and Cost Accountant with the Corps of Engineers, U. S. Army. From March 1937 to May 1939 I was an Examiner of Accounts with the Federal Power Commission. From May 1939 to November 1945 I was employed as a Special Agent with the U. S. Department of Justice; since November 1945 I have been with the Federal Power Commission. My duties with the Commission include the examination of the testimony and exhibits in gas certificate cases, insofar as such testimony and exhibits relate to the proposed financing of the projects to be constructed under the certificate proceedings, for the purpose of assisting staff counsel in the preparation of cross-examination, and to prepare recommendations thereon for the Commission as to the financial feasibility of proposed projects.

I also direct research in connection with the subject of fair rate of return for electric and natural gas utilities. I have testified as a Commission staff witness before the Federal Power Commission on the subject of rate of return in the following proceedings;

(a) In the Matter of

City of Pittsburgh vs. Pittsburgh and West Virginia Gas Company, Docket G-635.

(b) Otter Tail Power Company, Docket IT-6916.
(c) Pennsylvania Water and Power Company, Docket IT-5915.
(d) Ohio Fuel Gas Company, Docket G-1268.
(e) Hope Natural Gas Company, Docket G-1292.
(f) Northern Natural Gas Company, Dockets G-1382, G-1533, G-1607.
(g) Atlantic Seaboard Corporation, Docket G-1384.
(h) Mississippi River Fuel Corporation, Docket G-1641.
(i) Colorado Interstate Gas Company, Docket G-1115.
(j) Panhandle Eastern Pipe Line Company, Docket G-1116.
(k) Natural Gas Pipeline Company of America, Docket G-1697.
(l) Michigan-Wisconsin Pipe Line Company, Docket G-1678.
(m) El Paso Natural Gas Company, Docket G-2018.
(n) Hope Natural Gas Company, Docket G-2303.
(o) United Gas Pipe Line Company, Docket G-1142, et al.

I have twice appeared before the Utah Public Service Commission as a staff witness for that Commission, the first time in June 1947, Re: Mountain Fuel Supply Company, and in June 1949 Re: Utah Power & Light Company. In July 1949 I appeared before the Public Service Commission of the State of Vermont as a witness for the staff of that Commission in the matter of Central Vermont Public Service Corporation, and in May 1950, I again appeared before the Commission as a rate of return witness in the matter of Newport Electric Division of Citizens Utilities Company.

Q. Mr. Goubleman, have you prepared a rate of return study for use in this proceeding?

A. Yes, sir, I have prepared such a study.

Q. I direct your attention to Exhibit No. 18. Is this the exhibit to which you have just referred?

A. Yes, it is.

Q. Will you state generally the sources from which you have obtained the data and information contained in that exhibit?

A. Moody's Public Utilities Manuals, Cumulative Index and Bond Survey, Securities & Exchange publications, Standard & Poor's Stock Guide and Bond Guide, Standard and

Poor's Standard Corporation Descriptions, Bank and Quotation Record published by William B. Dana Company, New York, Federal Reserve Bulletins, FPC Forms No. 1, company reports to stockholders, and company's prospectus.

Q. What principles were followed by you in the preparation of Exhibit No. 18.

A. I followed the principles laid down in *Power Commission v. Hope Natural Gas Company,* 320 U. S. 591, which reads as follows:

> "From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. Cf. *Chicago & Grand Trunk Ry. Co. v. Wellman,* 143 U. S. 399, 345-346. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. See *Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Commission,* 262 U. S. 276, 291 (Mr. Justice Brandeis concurring)."

Q. What is the purpose of the exhibit?

A. The purpose of this exhibit is to furnish the Commission with comprehensive pertinent financial data on which it can rely in the exercise of judgment as to the fair and reasonable rate of return for South Carolina Generating Company.

Q. Mr. Goubleman, without attempting to restate the data or information set forth in the exhibit, will you briefly explain Exhibit No. 18?

A. The first section of the exhibit, comprising pages 1 through 6b, sets forth data by months showing the average interest rates on outstanding bonds of the U. S. government, industrials, railroads, and utilities, for the period January 1920 to the present time.

The yields on the outstanding U. S. Treasury Bonds, pages 1a through 1c were compiled by the U. S. Treasury Department and published in the monthly Federal Reserve Bulletins. The chart on page 1 was prepared from this data by

the staff of the FPC under my direction and supervision. Yields on the industrial, railroad and utility bonds included on pages 2a through 6b were compiled and published by Moody's Investment Services. The charts on pages 2 and 3 were based on the data shown on the lettered sheets following the charts. Such charts were prepared by the FPC staff under my direction and supervision. All of the yields included in pages 1 through 6b are based on day-to-day market transactions of outstanding securities as differentiated from newly issued securities.

Page 7 and lettered pages which follow set forth by ratings data relative to the cost of all bonds issued by electric operating utilities to the public by years since 1945 as reported by Moody's Services. For the years 1946 through 1954 the data is summarized by years and ratings and the supporting data are set forth in Appendix A. The available data for the year 1955 appear on pages 7b and 7c. On pages 7d-7e are shown the cost of issuing bonds according to size of issue.

On page 8 and the lettered pages which follow are set forth similar information with reference to all issues of preferred stocks to the public by all electric operating utilities since 1945, as reported by Moody's Services. The data are summarized by years for the period 1946 through 1954 and the supporting detail appears in Appendix B. Page 8a sets forth the yields to the public and cost to the company of electric preferred issues sold during the year 1955 insofar as such data are available.

On page 9 and lettered pages which follow are listed all the issues of common stock sold in their entirety to the public by all electric operating utilities for the period 1946 to date, as shown in Moody's Services. Included therein for each issue are the earnings offering price ratio, yield to purchaser, payout at time of offering, and the *capital ratios of the company prior to the offering.*

Page 10 and lettered pages which follow set forth the earnings-price ratios and yields on the common stocks of groups of electric utilities by months since January, 1940. It will be noted that the series which originally comprised ten electric operating utilities has been gradually expanded so that commencing with 1950, 25 utilities comprise the series. The revenues of those utilities are derived chiefly from electric oper-

ations. These utilities were selected to include companies of various sizes and to represent the various sections of the entire nation. The list has been confined to companies, the common stock of which is in the hands of the public, is traded on a recognized exchange with quotations available almost daily, and whose dividends have been paid for a number of years. The identities of the companies are set forth on page 10c. Page 10d sets forth the earnings-price ratio and yield on the common stock of each company for February, 1955, together with the composite earnings-price ratio of the group for February, 1955, which is shown on page 10b. The earnings price ratios and yields for each month, commencing with 1940 as shown on pages 10 through 10b were computed in the same manner as that for February, 1955, as shown on page 10d. Page 10e is a summary of the earnings-price ratios, yields, payouts of the 25 companies for the month of February, 1955, together with the capital ratios of these companies at December 3, 1953, the latest date for which complete data are available. Page 10f sets forth the composite yields on the outstanding preferred stocks of the same groups of utilities by months since January, 1940. On page 10g are shown the detail supporting the yield shown on page 10f for February, 1955. Each of the yields on page 10f was developed in the same manner as shown on page 10g. Page 10h sets forth the earnings-price ratios by months since January, 1950, of those electric utilities which have annual operating revenues ranging from 25,000,000 to 50,000,000, and whose common stocks are traded on an exchange. The annual revenues of South Carolina Electric & Gas Company during the past three years have fallen within this range.

Pages 11 through 15 set forth data relating exclusively to South Carolina Electric & Gas Company, parent of South Carolina Generating Company. Inasmuch as all of the debt of the Generating Company is held privately and all of the stock is owned by Electric & Gas, market quotations on the securities of the Generating Company are not available.

In view of the foregoing it was deemed appropriate to set forth financial data relating to Electric & Gas inasmuch as investors in the debt securities of the Generating Company would look beyond that company to the over-all financial set-up of Electric & Gas Company. Likewise, investors in the

securities of Electric & Gas Company would be interested not only in the parent company but also its subsidiaries and the system as a whole.

Page 11 sets forth the capitalization and capital ratios of Electric & Gas system as of December 31, 1954. At that time debt comprised 62.8%, preferred stock 9.4%, and common stock and surplus 27.8% of the total capitalization. Reference is made to page 10c which sets forth the composite capital ratios of the 25 companies at December 31, 1953, the latest data for which information is available. It will be noted that with reference to the 25 companies debt comprised approximately 50%, preferred stock 12%, and common equity about 38% of the total capitalization.

Page 12 shows the cost of the outstanding debt of Electric & Gas system as 3.46%, and preferred stock as 4.9%.

Pages 13 and 14 set forth the earnings-price ratios and yields on the common stock of Electric & Gas by months since January, 1950. Comparison of these figures with those for the 25 companies appearing on pages 10 through 10b shows that while the figures for Electric & Gas have been somewhat higher in earlier years, the spread between those for Electric and Gas and those for the 25 companies has narrowed considerably. For example, the average yield on the common stock of Electric & Gas for 1954 was 4.7%, which is 1/10 of one percent less than the 4.8% for the 25 companies. The earnings-price ratios for 1954 average 7.2% as against 6.3% for the 25 companies. This difference, no doubt, can be accounted for in great part by the relatively smaller size of Electric & Gas, the relative thinness of its common equity, its lower payout of earnings. On the average, the 25 utilities have been paying out during the past few years in excess of 70%, whereas Electric & Gas, as shown by page 16 of the Exhibit, has paid out from 58% to 67% of its available earnings. Likewise, comparison of the figures on pages 10b and 14 show that the common stock of Electric & Gas has been selling on as favorable a basis as the common stocks of the companies which are comparable in size to Electric & Gas.

Page 15 shows the offerings of common stock by Electric & Gas since 1947. All of these issues have been offered to the then common stockholders under preemptive rights at prices less than the prevailing market price of the stock.

Since 1949 these offerings have been made on an offering-price ratio and net offering-price ratio of less than 8.2%. Since the issue of 1949 all offerings have been made at prices approximately equal to or substantially in excess of the book value of the common stock.

Page 16 shows the per share earnings dividends and range of market prices of the Electric & Gas common stock for the years 1950 through 1954. It will be noted that since 1951 the average market price of the common stock has exceeded the book value and, in 1954, the average market price was in excess of 160% of the book value.

Exhibit 44

TESTIMONY OF KENNETH L. SMITH

My name is Kenneth L. Smith. I am employed by the Federal Power Commission as Supervisory Auditor, and reside in Bethesda, Maryland. I obtained my formal education in accounting, finance and business at the College of Commerce and Business Administration of the University of Illinois, receiving a Bachelor's Degree in 1927 and a Master of Science Degree in 1937. In 1930 I acquired the Illinois C.P.A. Certificate by examination and was granted a Colorado C.P.A. certificate in 1946 under a reciprocal arrangement. I hold memberships in the American Institute of Accountants, American Accounting Association, Federal Government Accountants Association, as well as Beta Gamma Sigma and Beta Alpha Psi, the latter two being collegiate professional and honor societies.

From 1927 to 1934 I was employed by F. W. Lafrentz & Company, a national firm of certified public accountants. From 1934 to 1936 I was top senior accountant in the Chicago office of Deloitte, Plender, Griffiths & Company, an international firm of public accountants. This nine years of public accounting experience was quite diversified, but was mainly concerned with audits, tax returns and special investigations for public utility clients.

From 1936 to 1945, except for one period of ten months, I was employed by the Federal Power Commission. My posi-

tion was Principal Examiner of Accounts until May 1941 and then for more than four years I served as Assistant Chief Accountant. Most of the natural gas rate investigations by the Commission during this period were under my direct supervision with respect to the accounting phases. I also testified on such matters as the rate base, cost of service, original cost principles, depreciation principles, working capital and participated extensively in the preparation of financial and accounting data which went into the briefs relating to the cases reviewed in the Federal courts. Important cases upheld in the Federal courts in which I testified and had substantial responsibility were the Canadian River-Colorado Interstate and Cities Service Gas Company cases reported at 3 FPC 32 and 3 FPC 459, respectively.

From 1945 to 1951 I resided in Denver, Colorado. Although my major activity during this period was rendering services to various clients on rate and financial regulatory matters, I served the University of Denver for a period of about two years as Professor of Accounting. I also served, on a part time basis, in the non-partisan administration of Mayor Quigg Newton as Manager of Revenue for the City and County of Denver (in 1948) and as the City's Utilities Officer (1950-1951). While Manager of Revenue I supervised the sale on behalf of the City of some $8,000,000 of general obligation bonds in addition to the routine supervision of a department having 300 employees. This department performs the assessment, collection and distribution of state, local and school district property taxes as well as the city sales and excise taxes. It also issues all automobile licenses in the City and County of Denver.

During the period I served as Utilities Officer, Denver enjoyed "home rule", with power to regulate utility rates and services. As Utilities Officer I was the city's representative in substantially all of its relationships with the electric, gas, telephone and mass transportation utilities, as well as taxicab companies, operating in the city. I also represented the city in all matters pertaining to Denver's utility services (other than water), before State and Federal regulatory agencies made continuing studies and performed numerous routine duties relating to utility rates and services in the city,

and advised the Mayor and City Council on policy matters pertaining to public utilities and taxicab operators.

In 1951 I returned to the Federal service as Assistant Controller of the Rural Electrification Administration. I had the major responsibility for shaping the accounting and auditing policies followed by REA and recommended by it to its borrowers. I also served as the principal consultant to the agency on financial matters affecting borrowers. In 1953, upon abolishment of the controller and auditing functions of the REA staff, incidental to a major reorganization, I returned to the staff of the Federal Power Commission in my present capacity.

For use in this proceeding I have prepared Exhibit No. ....., consisting of two schedules, which sets forth the cost of service and rate base related to sales to Georgia Power Company for the year 1956 based on the showing made by the company in this proceeding. An assumed rate of return of 5½% and an assumed Federal income tax rate of 52% were used in computing such cost of service. I am not necessarily recommending, however, that these percentages be adopted for return and tax rates. While their use is provisional in this study, the methods of applying whatever rates are found proper for return and Federal income tax are appropriately illustrated in the Exhibit. Also for the purpose of classifying the various items of cost of service between energy and capacity costs the general pattern provided in Power Contract dated November 9, 1951 between the respondent and Georgia Power Company was followed.

Data for the year 1956 were selected to indicate the cost of service which can be expected to be representative of the immediate future. Beyond the immediate future foreseeable changes in the rate base and other possible changes will undoubtedly alter the results shown in this exhibit.

While the exhibit is based on data and information relating to the year 1956 in the showing of South Carolina Generating Company, I have made several modifications of the company's conclusions in order to obtain a proper cost of service. A field examination would possibly reveal the necessity of further adjustments. My modifications are summarized briefly as follows:

Item No.

1. The rate of interest capitalized during construction on equity funds has been reduced from 8% to 6% per annum.
2. A composite annual depreciation rate of 2.75% has been applied in accordance with the company's practice in keeping its books and issuing financial reports to investors, in preference to the 3% annual rate claimed by it for rate making purposes in this proceeding.
3. Interest deductions used for the purpose of computing the Federal income tax allowance are those for the actual financial structure of this company in preference to an assumed capitalization proposed by the company.
4. A depreciation rate of 3.25% was used in computing the Federal income tax allowance, representing the rate claimed and expected by the company to be allowed by the Internal Revenue Service, for income tax purposes. The company used 3%.
5. The company's claimed cash working capital has been reduced by eliminating natural gas purchased from the operating expenses for which cash working capital must be provided and by making a deduction for working capital funds provided to the company through income tax accruals collected from customers in advance of actual payment thereof to the tax collecting agency.

Further discussion of the necessity and propriety of these modifications is as follows:

Item No. 1—Interest During Construction

Electric Plant Accounts Instruction No. 5 (Paragraph 17) of the Commission's Uniform System of Accounts provides for capitalization, at a reasonable rate of interest during construction associated with the use of the utility's own funds. This applies to equity funds. In several decisions the Commission has held that 6% per annum on equity funds is the maximum reasonable rate for the purpose of computing interest during construction. Among the decisions in point are the following:

Northern Natural Gas Company, Opinion No. 228, P. 11 (Mimeo.ed.) June, 1952.

Michigan-Wisconsin Pipe Line Company, Opinion No. 275, p. 14 (Mimeo. ed.) July 1954.

Transcontinental Gas Pipe Line Corporation, order of November 9, 1954 in Docket No. G-2075.

Accordingly, Interest on Equity funds in the amount of $242,154.39 appearing on Exhibit No. 20 was reduced to $181,616, resulting in a downward adjustment of approximately $60,538 to Plant Account. One-half of this deduction or $30,269 was excluded from the rate base I use.

Item No. 2—Depreciation Rate

Since the management of South Carolina Generating Company has used an annual depreciation rate of 2.75% for operating, financial and reporting purposes, with the approval of independent public accountants, the only justification for using a different depreciation rate in this case would be a showing that the 2.75% rate is erroneous or otherwise inappropriate for the purpose of computing the reasonable cost of service. The testimony of Mr. W. J. Ready at Page 7 of Exhibit No. 2 and at pages 618 to 648 and 848-849 of the transcript has to do with this matter.

I understand Mr. Ready's testimony to mean, in essence, that increasing the annual depreciation rate from 2.75% to 3% is justified for the purpose of this rate case because of impending changes in the art, proximity of the plant to alleged extraordinary potential physical hazards and the risk of error inherent in making long range estimates.

With regard to impending changes in the art, South Carolina Generating Company, as I understand the facts, is not in a different position from other producers of electrical energy generally and Mr. Ready testified that producers generally have not increased their depreciation rates due to such a factor. It is common knowledge that depreciation rates used by electric utilities generally during at least the past 15 to 18 years reflect an allowance for changes in the art.

So far as the hazard and risk referred to are concerned there is likewise no justification for increasing the depreciation rate to 3%. It is not the purpose of the annual depreciation allowance to provide compensation for such hazards and risks. In this connection I might refer to definition No. 13 of the Uniform System of Accounts. Therein depreciation is

specifically restricted to factors "known to be in current operation and against which the utility is not protected by insurance." Causes specifically listed in the definition are "wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities." This does not mean, however, that the utility is denied compensation for its risks. Through a recognition of its capital costs, as determined by the market place, in accordance with principles enunciated in the *Bluefield* and *Hope Gas Company* cases, such risks are compensated for in the rate of return allowance. To compensate these risks again in the depreciation allowance would result in duplicate charges against the ratepayer and a windfall to the utility.

Item No. 3—Interest Deductions for Income Tax Computation

South Carolina Generating Company contemplates filing a separate Federal income tax return for the calendar year 1954. According to the evidence it appears likely, however, that Generating Company's operations will be included in a consolidated return in 1955 and some years thereafter in order that its parent can realize, at least temporarily, the tax advantages flowing from rapid amortization of certain of the Generating Company's facilities.

The respondent proposes to substitute hypothetical interest deductions for actual in computing the income tax allowance. This raises the question of whether such extraordinary procedure would result in the fairest possible distribution of the tax cost consistent with the existing relevant facts.

The company contends that the interest deduction for the purpose of computing the income tax allowance in this case should be on the basis of hypothetical 50% ratio of debt to total capitalization. This would have the effect of increasing the tax allowance, with a consequent benefit to the parent company. Although it is claimed that the desirability of a 50% debt ratio, and the practice of the industry warrant an expectation that the Electric and Gas Company system on a consolidated basis will attain such a debt ratio at some undetermined time in the future the fact remains that a 50%

ratio is non-existent at this time and there is no assurance that it will be attained at any particular time.

Even if the system had, or expected to attain, a 50% debt ratio at some specific date, the company's position with regard to this tax deduction would rest on the premise or assumption that the Generating Company is no more than a department of the parent company or of the parent and subsidiaries as a group. This approach has merit in some instances but it does not square with realities when the manner of assessing and collecting income taxes is fully considered. Based on a fundamental principle of cost accounting, in making a fair and reasonable assignment of the tax cost, as in this case, the realities cannot be ignored. Of significance are the following considerations:

Generating Company is a separate corporate entity; it is the contracting and operating entity which renders the service to Georgia Power Company and other customers; it is entitled to file a separate tax return; it would file a separate return were it not for the benefits to the parent flowing from filing a consolidated return; Generating Company has certain specific deductions for interest to which it would be entitled and would use upon the filling of a separate tax return; the benefits of Generating Company joining in filing a consolidated return flow entirely to the parent company with no portion thereof accruing to Generating Company; joining in the filing of a consolidated return does not deprive Generating Company of its status or alter its responsibilities as a separate corporate entity and taxpayer.

In view of the facts, the conclusion that sound cost accounting requires the use of Generating Company's own interest deductions in computing its income tax allowance for rate making purposes is, in my opinion, inescapable. To conclude otherwise would result in using a synthetic tax allowance not consistent with the underlying facts. Under the company's proposal the customer would be required, in my opinion, to pay for more in the income tax component of cost of service than the taxes actually payable by Generating Company. They would also pay more than can be allocated to the Generating Company's cost of service in accordance with good accounting practice.

Item No. 4—Use of 3.25% Depreciation Rate for Income Tax Computation

The Company stated that it has claimed 3.25% for depreciation on its Federal income tax return and expects such amount to be allowed by the Internal Revenue Service for statutory purposes. Under these conditions the use of a lower depreciation rate in computing the income tax allowance for the purposes of this rate case would return the company an additional profit over and above the fair return. The imposition of any such duplication of costs on the customers is not proper accounting and would be erroneous as a procedure in fixing utility rates.

Item No. 5—Working Capital Allowance

The purpose of the working capital allowance in rate-making is to enable the utility to earn a fair return on the materials, supplies and cash devoted to the utility operations to the extent that these are actually provided by investor's funds. Customers may also provide working capital funds to the utility by paying for service in advance of the time the utility pays for the costs, or some of the costs, of providing the service. It is fundamental, therefore, that capital supplied by the customers should not be included in the rate base. This requires consideration of the time revenues are collected from customers in relation to the time payment is made of various expenses.

Exhibit 24 shows that Georgia Power Company pays its power bill by or before the time Generating Company pays its bill for gas consumed in rendering the service to Georgia. Accordingly, it is not necessary to provide working capital from investors' funds for payment of Generating Company's gas bills.

The Federal income tax is another element of cost of service not paid by the utility until after a substantial lapse of time subsequent to recovery of such cost from customers through bills paid for service. The Federal Power Commission's standard practice of taking into account in the working capital allowance the tax accrual funds provided by customers to the utility in advance of payment thereof to the taxing authorities has been approved by the courts. Refer-

ence is made to *Alabama-Tennessee Natural Gas Company* v. *F. P. C.* 203 F2d 494 and *Northern Natural Gas Company* v. *F. P. C.* 206 F2d 690, certiorari denied, 346 U. S. 922.

For 1956 the portion of the Federal income tax allowance to be credited to the customer's contribution of working capital, in accordance with the Commission's policy of taking into account the lag between the time of collection and payment of Federal income tax funds by the utility, is 68%. This percentage has been utilized in computing the working capital allowance reflected in the rate base.

The testimony which follows is directed to cost classification and rate form. In my opinion, the classification of costs in my exhibit as between the energy and capacity components is suitable for use in connection with this proceeding. Although the separation followed in the Exhibit has the effect of allocating 100% of the fixed costs to the capacity component, it is believed to be suitable and reasonable for the purposes of this particular case. Under other conditions it might be appropriate to split the costs of depreciation, taxes and return on a 50-50 basis between the energy and capacity components. Here, however, in view of the right of Georgia Power Company to the capacity and the impracticability of Generating Company disposing of the output of the capacity devoted to Georgia service to other customers, the inclusion of all of the fixed costs in the capacity or demand charges to be paid by Georgia Power Company appears justified. It should be recognized, however, that by this method of cost allocation and rate making, substantially all of the risks associated with ownership of 50% of the capacity of the Urquhart Plant are shifted from Generating Company to Georgia Power Company. This is a very important consideration. Thus, Generating Company is assured, through Georgia Power Company's credit, and the latter's status as a sound going public utility, of a profitable, practically risk-free, tax-free investment in 50% of the plant. Generating Company's parent will obtain the rapid amortization tax benefits on the plant. In addition, according to the contract, Generating Company may terminate the service by giving the required notice, at any time conditions are such that the cancellation would be advantageous to Generating Company or its parent.

In the years subsequent to 1956, under normal conditions, Generating Company's rate base applicable to Georgia Power will decrease due to the increase in the depreciation reserve. The magnitude of the net decrease in the rate base will depend, however, to some extent upon the amount of plant retirements, replacements and additions which may be made to Units Nos. 1 and 2. These do not appear in the record.

As the rate base decreases the elements of cost of service to Georgia Power representing return and possibly income taxes would decrease. The present rate schedule of South Carolina Generating Company, FPC No. 1, however, does not adjust the charges to Georgia Power Company to reflect the decrease in rate base resulting from the accruals to the depreciation reserve.

Assuming that the depreciation reserve will increase yearly at the rate of 2.75% of depreciable plant, Generating Company's capacity cost of service to Georgia Power would decrease by roughly $1.30 to $1.40 per kilowatt during each five year interval after 1956.

Although return will be the substantial variant in terms of the dollars involved, other elements of cost may also be affected. Tax rates, assessments and other factors affecting the amount payable may change up or down. Operating expenses will probably vary. There is some indication that the Federal income tax rate may be reduced from 52% to 47% by next April 1.

Notwithstanding that changes in the cost to serve Georgia Power in subsequent years are certain to occur, it is my opinion that the Commission would be justified in prescribing a fixed annual charge for the present capacity service rendered to Georgia Power by Generating Company. Regulation is a continuing process. No rate can ever be regarded as fixed or appropriate for all time. The propriety and necessity of periodic re-examination is obvious. Such procedure unquestionably is fair and reasonable for all concerned.

The Exhibit shows that Generating Company's capacity cost to serve Georgia Power amounts to $1,632,640 for the year 1956. I recommend that the Generating Company's rate schedule provide for an annual capacity charge of this amount to be paid in equal monthly installments. In addition, the present energy charge provisions of FPC Rate Sche-

dule No. 1 would be retained. It would be necessary, however, to revise the capacity charge in the future depending upon the changes which may occur in the capacity cost elements.

Assuming that the Commission prescribes a fixed annual capacity charge, I do not recommend a provision, as in the present schedule to adjust such a charge automatically for changes in plant investment and expenses. Although it appears that the adjustment most likely to affect the result significantly would result in a lower charge, I do not favor retaining automatic adjustment of the demand charge, generally speaking. If the cost goes up, the Generating Company can apply for a higher rate; if it goes down, the Commission can and should prescribe a lower rate, after a reasonable interval has elapsed. The matter of adjusting the capacity charge for lowering of the Federal income tax rate will be covered subsequently in my testimony.

To provide for a fixed annual charge certain modifications of the present rate schedule are necessary. I suggest that those Sections in Article III which are inconsistent with the provision for a fixed annual charge payable monthly be eliminated from FPC Rate Schedule No. 1. In the first paragraph of Section 3.02 the amount of $21.769 per kilowatt would be substituted for the present $22.50 capacity charge. Section 3.02(a) should be retained, but Section 3.02(b), (c), (d), and (e) would be eliminated. Sections 3.03 and 3.04 would be retained and Section 3.05 should be modified so as to be consistent with the foregoing.

With the elimination of the so-called escalator clauses relating to the demand charge, I recommend that the second full paragraph of page 30 of Rate Schedule No. 1 be eliminated to permit either Generating Company or Georgia Power to petition the Commission for a change in the rate.

In addition to the foregoing it is recommended that any order of the Commission fixing a new demand charge provide for a reduction therein in the event the Federal income tax rate is lowered.

Exhibit 45

Attached to the Testimony of Kenneth L. Smith

SOUTH CAROLINA GENERATING COMPANY

Cost of Service
(Georgia Power Company Sales)
Year 1956

Particulars	Total	Cost Classification[1] Energy Costs[2]	Capacity Costs
Operation and Maintenance			
Fuel	$ 1,309,000	$ 1,309,000	$
Maintenance	33,400	32,900	500
Other	187,200		187,200
Total Operation and Maintenance	$ 1,529,600	$ 1,341,900	$ 187,700
Depreciation	372,985		372,985
Taxes—Other than Income	119,500	7,500	112,000
Income Taxes:			
Federal	210,743		210,743
State	43,247		43,247
Return at 5.50%	707,065		707,065
Credits for Rents	(1,100)		(1,100)
Total Cost of Service	$ 2,982,040	$ 1,349,400	$ 1,632,640
KWH (,000)		466,500	
Energy Cost per KWH		$ .0028926	
Contract Demand—KW			75,000
Cost per KW of Contract Demand			$ 21.769

[1] Classified between energy and capacity costs in accordance with the general pattern provided in Power Contract dated November 9, 1951.

[2] Statement 2(b)-1 of Exhibit No. 7

SOUTH CAROLINA GENERATING COMPANY

Rate Base and Return
Year 1956
(Georgia Power Company Sales)

Particulars	Amount	Source
Plant:		
Gross Average Investment	$ 13,674,331	Note (1)
Less: Average Depreciation Reserve	916,420	Note (2)
Average Net Plant Investment	$ 12,757,911	
Working Capital Requirement:		
Material and Supplies	$ 195,400	Statement 1(d) Ex. 7
Cash for expenses	45,725	Note (3)
Credit for tax accrual funds	(143,305)	Note (4)
Net Working Capital Requirement	97,820	
Total Rate Base	$ 12,855,731	
Return—at 5.50%	$ 707,065	

Notes—

[1] Average Plant—1956—Statement 1(d), Ex. 7 ..... $13,704,600
Adjustment to reduce interest capitalized on equity funds from 8% to 6%.... 30,269

As adjusted above $13,674,331

[2] Statement 1(b)-1 of Ex. 7 recomputed on basis of 2.75% rate.

[3] Represents ⅛ of operation and maintenance expenses exclusive of natural gas fuel purchased.

[4] Represents 68% of allowance for Federal income tax expense or the portion thereof available for working capital.

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Supreme Court of the United States

OCTOBER TERM, 1957

No. 697

SOUTH CAROLINA GENERATING COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION, ET AL.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Dated December 31, 1957

TABLE OF CONTENTS

	Page
I. Introduction	1
II. Opinions Below	1
III. Jurisdiction	1
IV. Questions Presented	2
V. Statutes at Issue	3
VI. Statement of the Case	3
1. The Parties and the Contract	3
2. The Action of the Commission	5
3. The Action of the Court of Appeals	7
VII. Reasons for Granting the Writ	8
1. The Decision Below Is in Conflict With the Rule Announced by This Court in Federal Power Commission v. Sierra Pacific Power Company	8
2. The Decision Below Is in Conflict With the Rule Announced by This Court in Montana-Dakota Utilities Co. v. Northwestern Public Service Co.	13
3. The Decision Below Conflicts With the Substantial Evidence Rule	15
VIII. Conclusion	17

Appendix A — Opinion of the United States Court of Appeals for the Fourth Circuit ..... App. 1

Appendix B — Sections 205 and 206 of the Federal Power Act ..... App. 31

TABLE OF AUTHORITIES

Cases

Page

Central Illinois Public Service Co., Re, 32 S. E. C. 202 (1951) 3

Colorado-Wyoming Gas Co. v. Federal Power Commission, 324 U. S. 626 (1945) 16

Memphis Light, Gas and Water Division v. Federal Power Commission, Court of Appeals for the District of Columbia Circuit, November 21, 1957 15

Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U. S. 246 (1951) 13, 14, 15

Federal Power Commission v. Sierra Pacific Power Co., 350 U. S. 348 (1956) 2, 8, 10, 11, 12, 13

Tyler Gas Service Co. v. Federal Power Commission, 247 F. 2d 590 (D. C. Cir., 1957), cert. denied, ... U. S. ..... (December 9, 1957) 10

United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U. S. 332 (1956) 9, 10

Statutes

United States Code:

5 U. S. C. § 1007(b) 16

16 U. S. C. § 824d 3

16 U. S. C. § 824e 3, 13

28 U. S. C. § 1254(1) 2

PETITION FOR A WRIT OF CERTIORARI

I.

INTRODUCTION

South Carolina Generating Company hereby petitions that a writ of certiorari issue to review an order of the United States Court of Appeals for the Fourth Circuit entered on October 23, 1957. That order remanded to the Federal Power Commission for further proceedings in accordance with the opinion of that court a proceeding relating to contract rates of the Petitioner, but that order failed, in the opinion of the Petitioner, to apply controlling principles announced by this Court and thus conflicts with recent prior decisions of this Court.

II.

OPINIONS BELOW

The opinion and order of the Federal Power Commission (I. 93)[1] is reported at 16 F. P. C. 52. The order of the Commission denying petitions for rehearing is reported at 16 F. P. C. 1365.

The opinion of the Court of Appeals, reprinted in Appendix A, has not yet been reported.

III.

JURISDICTION

The order of the Court of Appeals was entered on October 23, 1957. The Petitioner filed a timely Petition for

[1] The transcript of record as certified by the Clerk of the Court of Appeals consists of six volumes. The respective volumes are referred to herein by Roman numerals. Volume I is Part I of the Petitioner's Appendix in the Court of Appeals.

Rehearing which was denied by an order entered November 23, 1957. On December 3, 1957, that court entered an order staying transmission of its opinion and order on the condition that this Petition be filed within thirty days thereafter.

The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

IV.

QUESTIONS PRESENTED

The questions presented are three:

1. Is it contrary to the rule established by this Court in the *Sierra*[2] case to set aside contract rates between two unaffiliated utilities (neither obligated to serve the other) without a finding that the contract will result (*a*) in impairing the ability of one utility to render public service or (*b*) in placing an excessive financial burden on its customers?

2. Did the Commission err when it set aside the contract rates without a finding that the rate of return produced by such rates was excessive and outside the band of reasonableness?

3. Did the Court of Appeals err in returning the proceeding to the Commission simply to make subsidiary findings to support its conclusions when the record contained no evidence to support the conclusions?

The Petitioner submits that these questions, each of major significance in the field of utility rate regulation, should be answered in the affirmative.

---

[2] *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. 348 (1956).

V.

STATUTES AT ISSUE

The pertinent statutes are §§205 and 206 of the Federal Power Act (16 U. S. C. §§824d, 824e) and are quoted in Appendix B.

VI.

STATEMENT OF THE CASE

1.

The Parties and the Contract

South Carolina Electric & Gas Company (E. & G.) is, among other things, an electric generating and distributing company serving a wide area of South Carolina. The territory in Georgia adjacent to its service area is served by Georgia Power Company (Georgia Power). The Georgia and South Carolina Commissions regulate electric rates within their respective States and are on opposite sides of this case here.

The Atomic Energy Commission (A. E. C.) decided to build a plant on the Savannah River in E. & G.'s service territory and needed a substantial supply of electric energy. E. & G. and A. E. C. (acting through its agent, duPont) could not work out a satisfactory rate. It was vital to E. & G. that the plant be constructed (to further the development of the service area) and that it be supplied by E. & G. (to prevent the emergence of a competitive source of energy).

The solution was the formation of the Petitioner. Following an A. E. C. precedent,[3] it was to build a new plant and

[3] See *Re Central Illinois Public Service Co.*, 32 S. E. C. 202 (1951), and subsequent releases.

was to be capitalized with a 90% debt capitalization. The 10% equity was purchased by E. & G. Capitalization on this basis was possible only because the Petitioner negotiated with its customers long term contracts for the sale of energy. With costs reduced by such a capitalization, a contract with A. E. C. was arranged.

Meanwhile, Georgia Power, which is not affiliated in any way with E. & G., required additional capacity in its adjacent service area. Studies indicated that substantial savings would be achieved by purchase from the Petitioner rather than construction of an independent station by Georgia Power. After protracted negotiations, a contract was executed on November 9, 1951, by the Petitioner and Georgia Power for the sale and purchase of energy.

This agreement, filed with the Commission on July 24, 1953, is the basis of controversy here. It provided Georgia Power with 75,000 kw of capacity (from a plant to consist of two units of 75,000 kw each) with the right to one-half of the capacity of one unit in the event of failure of the other. But the Petitioner might cancel the contract in whole or in specified part on notice.

The rate was a two-part rate. The capacity component was designed to retire the allocated investment, reimburse the Petitioner for certain expenses and provide for equal sharing between Petitioner and Georgia Power of the substantial savings resulting to the latter from the contract. The energy charge included the cost of fuel, maintenance and related taxes. Both the capacity charge and the energy charge were subject to escalation pursuant to fixed formulae as costs changed.

All parties considered the contract advantageous. It assured E. & G. of the ability to serve its established territory and the growing commercial and residential load to result from the A. E. C. plant. Yet there were concom-

itant disadvantages. From an economic viewpoint, E. & G. and the Petitioner were a unit. E. & G. had to undertake equipment and other liabilities of major proportions. It had to provide reserve capacity. It had to improve and rearrange its transmission system. Most important, because of the unitary economic nature of the system, it had to offset the Petitioner's high debt ratio by deriving an unusually high proportion of its funds for capital expansion from the sale of equity rather than debt securities. From 1951 to 1954, E. & G.'s common equity increased from 26% to 35% of total capitalization but on a basis consolidated with the Petitioner the increase was only from 26% to 28%. In those years, 72% of the increase in capital of E. & G. was in the form of common equity and only 10% in the form of debt. E. & G.'s expansion during the period, primarily because of the existence of the Petitioner, was financed with money costing 10% per annum rather than 3½%.

The advantage to Georgia Power was even more clearly marked. It is agreed by the parties and was found as a fact by the Commission that the purchase of the energy from the Petitioner at the contract rate resulted in a yearly saving to Georgia Power of $600,000 that it would have otherwise had to pay if it obtained the capacity from any other source. It is, furthermore, clear that energy in the amount purchased was necessary if Georgia Power were to continue to supply the demands of its customers.

So all three of the utilities were pleased with the contract. But at this point the Commission intervened.

2.

The Action of the Commission

After conferences and consultation, the Commission initiated an investigation of the contract rate in October 1954 (I. 13, 18). A full hearing resulted.

On March 1, 1956, the Presiding Examiner issued a full report (I. 29-93). He upheld the contract rate and dismissed the proceeding. His thorough review of the testimony presented and the issues resulting therefrom warrants careful study for full understanding of the issues in this case.

Exceptions to the report of the Presiding Examiner were filed by the staff of the Commission and by the Georgia Commission. On October 24, 1956, the Commission over the dissent of Commissioner Digby discarded the findings of the Presiding Examiner and ordered the contract rate reduced by an estimated $252,186 per year (I. 93-120).

The Commission recognized that the contract was the result of arm's length bargaining (I. 99). But that was of no moment to the Commission. It brushed aside two recent and relevant decisions of this Court and determined to make only its usual formalistic cost-of-service test of the contract rate (I. 100-2).

The Commission turned next to a rate of return determination (I. 103-9). It made no finding that the rate of return to be produced by the contract rate (approximately 6%) was outside the band of reasonableness. Instead, it set about to find its own pinpoint rate of return. It took the capital ratios of E. & G. and the Petitioner as a unit (although it did not use the latest figures of record), determined a system cost of money for each component of the capital structure, factored them together and concluded that 5.55% was a reasonable rate of return.

It turned next to the income tax allowance for the Petitioner (I. 109-10). It recognized that, because of its large interest charges resulting from its high debt ratio, the income taxes of Petitioner standing alone were abnormally low. Yet, contrary to its action on rate of return, the Com-

mission refused to follow a system basis on income taxes but, inconsistently, allowed only the Petitioner's abnormally low individual taxes. The difference is substantial; by this action, the Commission would deprive the Petitioner of almost $190,000 of additional revenues (I. 130). This is 75% of the rate reduction ordered by the Commission.

Next, the Commission rejected for unspecified reasons the escalation provisions of the capacity charge, except to the extent that changes in Federal income taxes might affect that component of the contract rate. Strangely enough, it did not change the related escalation provisions affecting the energy charge.

Finally, the Commission rejected the Petitioner's proposal that interest during construction on funds costing, as the record showed, 10% per annum be accrued at an 8% rate. It reduced this rate to 6% simply because the lower rate was

". . . consistent with our past practice." (I. 111-2)

Other adjustments not at issue here were made and the order lowering the contract rate was entered. A petition for rehearing (I. 121-30) was duly filed, and rehearing was denied (I. 135-9).

3.

The Action of the Court of Appeals

The Court of Appeals did not affirm the order of the Commission, although the dissenting judge would have done so. Instead, it sent the proceeding back to the Commission. But its action failed to recognize the conflict between the determination of the Commission and the decisions of this Court.

The Court of Appeals first held that the rule announced

by this Court in the *Sierra* case was inapplicable here. Its reasoning was erroneous as we shall develop below. It turned next to income taxes. It found that the Commission did not explain why rate of return was determined on a system basis and income taxes on a separate company basis; it therefore directed the Commission to explain its conclusions as to the latter. It required the Commission to furnish similar explanations of its conclusions as to the escalation provisions relating to the capacity charge and the proper rate for the accrual of interest during construction; it did not consider whether there was evidence to support these conclusions. It affirmed the Commission on the rate of return determination without mention of whether the rate of return produced by the contract rate was within or without the band of reason.

Since the position of the Petitioner on its main point of general interest was overruled by the Court of Appeals and the way was left open for the Commission simply to mend its fences without according the Petitioner a further hearing, the Petitioner, in view of the importance of the principles involved, had no choice except to apply to this Court for review.

VII.

REASONS FOR GRANTING THE WRIT

1.

The Decision Below Is in Conflict With the Rule Announced by This Court in Federal Power Commission v. Sierra Pacific Power Company.

We start with two economic premises. First, the Federal Power Act promotes contracts between utilities that are

not affiliates when resulting from arm's length bargaining. It is of economic importance that such contracts, unless clearly detrimental to the public interest, be sustained. This principle is self-evident. Millions of dollars are invested by utilities. These dollars are obtained from savings, whether accumulated by institutional investors or otherwise. Business enterprises are, in general terms, of value only because of earnings. Where, as here, earnings are dependent on contractual relationships, the abrogation of contracts is destructive of value. That is not in the public interest. Future development will be frustrated if the parties to contracts cannot rely on their effectiveness.

Second, a utility has no source of revenues except from its customers. If the overall level of revenues is not excessive, the reduction of rates to one segment of customers means only that another segment must pay more.

The decision below disregards both of these premises. It authorizes the Commission to strike down an agreement relating to service which the selling party had no duty to render and the buying party had no duty to accept and it does so without finding that the agreement imposes any undue burden on either party. It transfers from the ratepayers of Georgia to the ratepayers of South Carolina the duty of providing $258,000 of revenues without any determination of the relative equities of the parties.

We start with these premises advisedly for their violation illustrates the importance of this case. And this Court has expressed a regard for contracts of the nature of that under review here that is not shown either by the Commission or by the Court of Appeals.

Electric rates are not "fixed" by the Commission; the power of the Commission is simply to review rates established by the utility. That is the rule of *United Gas Pipe*

Line Co. v. *Mobile Gas Service Corp.*, 350 U. S. 332 (1956).[4] Furthermore, the Act promotes the use of contracts between utilities. As this Court said in the *Mobile* case:

> "In construing the Act, we should bear in mind that it evinces no purpose to abrogate private rate contracts as such. To the contrary, by requiring contracts to be filed with the Commission, the Act expressly recognizes that rates to particular customers may be set by individual contracts." (350 U. S. at p. 338.)[5]

Next, we come to the standard that is to be followed by the Commission in reviewing a contract rate. That rule was made unmistakably clear by this Court in *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. at pp. 354-5, when it said:

> "In short, the Commission holds that the contract rate is unreasonable solely because it yields less than a fair return on the net invested capital. But, while it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain. Cf. *Arkansas Natural Gas Co.* v. *Railroad Comm'n*, 261 U. S. 379. In such circumstances the sole concern

[4] That case arose under the Natural Gas Act but the Court pointed out in the companion case that the provisions of the Federal Power Act relevant to this case "are substantially identical" to those of the Natural Gas Act. *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. 348, 350 (1956).

[5] See, for a very recent application of this rule, *Texas Gas Service Co.* v. *Federal Power Commission*, 247 F. 2d 500 (D. C. Cir. 1957), *cert. denied*, ... U. S. ... (December 9, 1957).

> of the Commission would seem to be whether the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory."

If the same rule applies in this case, as it should, the Commission did not find and could not have found that the contract rate at issue here would impair the ability of Georgia Power to continue its service, cast an excessive burden upon the consumers served by Petitioner (directly or indirectly) or by Georgia Power or be unduly discriminatory.[7] Georgia Power directly and its customers indirectly were saved $600,000 a year because of the contract; if the contract capacity had not been made available, this additional annual cost would have been inevitable, as the Commission found and all parties here agree. Thus the contract confers a benefit on Georgia Power and its customers; it imposes no burden, excessive or otherwise.

The Court of Appeals held that the rule of *Sierra* was applicable only when rates are too low (within the meaning of the Commission's mechanical tests); here, that court said, the rates were, in the same terms, too high and a different rule applies. It said that the inquiry here was only

> ". . . whether the utilities were justified in retaining for themselves the savings . . ."

provided by the existence of the Petitioner and concluded that the parties were not

> ". . . entitled to all the savings which actually flowed

[7] The Commission expressly refused to find discrimination in this case (J. 98, 130).

from the natural growth and economic development of the area."

This is the only reason given by the Court of Appeals for refusing to apply the *Sierra* rule here. This reasoning is based on clear economic misconception. The economic question was not whether the Petitioner or E. & G. would retain for their stockholders an excessive recovery from Georgia Power; the question is simply whether Georgia customers should receive free the advantages derived from creation of the Petitioner and leave the weight of the burdens that resulted from its creation squarely on South Carolina customers, or whether there should be an equitable sharing of those burdens. No utility is "entitled" to keep any "savings"; the question is rather which customers will receive the benefit of savings. The economic realities are as clear here as in the reverse situation presented by *Sierra*.

The *Sierra* case established an important rule. Two utilities are entitled to bargain at arm's length and their agreements are to be respected unless shown to be definitely contrary to the public interest. This is an important rule. If contracts are not, in the ordinary case, to be respected, businessmen will not enter into them, for the stability of future long-term arrangements cannot exist if the Commission may at any time and from time to time substitute its judgment for that of the contracting parties. Investors will not supply funds for capital expansion unless reasonably assured by contract of a reasonable return. If the Commission can rewrite all such contracts at any time, future certainty is destroyed and investors will seek other opportunities for investment. In result, joint enterprises in the electric utility field must of necessity disappear and each separate com-

pany will continue its solitary development. This result will be disadvantageous to the industry and to the economy of the country as a whole which depends to so large an extent on the carefully planned development of this single industry.

The *Sierra* rule is a salutary one. It is important that the full meaning of the rule be reestablished and made unmistakable. The Commission does not like the rule: that it true because the rule tends to reduce the Commission from dictator in the field to regulator, its proper function. The Commission has frustrated the rule in this case, and it has received the support of the Court of Appeals.

The Commission should not be permitted to usurp powers denied it by the Congress and the decisions of this Court. For this reason, the decision below should be reviewed and reversed.

2.

The Decision Below Is in Conflict With the Rule Announced by This Court in Montana-Dakota Utilities Co. v. Northwestern Public Service Co.

The Company contended before the Commission that 6% was a reasonable rate of return. The Presiding Examiner supported this position. The Commission disregarded this evidence. The Commission never attempted to determine the actual rate of return under the contract rate. If the Commission had made the required adjustment to income taxes, the rate of return under the contract rate would have been less than 6%. It was this failure to make the proper adjustment for income taxes that the Court of Appeals has directed the Commission to explain.

The first duty of the Commission was to determine whether or not the contract rate was just and reasonable. That is prescribed by §206(a) of the Federal Power Act.

To determine whether the contract rate was just and reasonable required a determination of the rate of return produced by it. All that the Commission did was to determine a single rate of return (5.55%) that it considered reasonable. It said:

> ". . . we arrive at an allowance for over-all rate of return of 5.55%." (I. 108)

The Court of Appeals, disregarding the first duty of the Commission, says simply that

> ". . . the finding of the Commission on this point should not be disturbed."

If the responsibility of the Commission had been to make an initial rate of return finding, its action might have been justified. But it cannot adopt the position that 5.55% is the single and only fair rate of return. This Court has told it that there is no single and only fair rate of return. In *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U. S. 246, 251 (1951), this Court said:

> "Statutory reasonableness is an abstract quality represented by an area rather than a pinpoint. It allows a substantial spread between what is unreasonable because too low and what is unreasonabe because too high."

If a reasonable rate of return is an area rather than a pinpoint, the duty of the Commission here was to determine whether the rate of return produced by the contract rate lies within the area. The Commission never mentioned area or range. Indeed, the Court of Appeals never said that the Commission had the duty first to look at the contract rate

to determine whether it was reasonable before launching into its independent rate of return determination.

Our proposition here has the support of a very recent decision of a Court of Appeals. In *Memphis Light, Gas and Water Division* v. *Federal Power Commission*, decided by the Court of Appeals for the District of Columbia Circuit on November 21, 1957, Judges Bazelon and Washington make it clear that, in a proceeding under §5(a) of the Natural Gas Act or §206(a) of the Federal Power Act (as here), the Commission must first determine that the existing rate is outside the band of reasonableness (see pamphlet opinion, p. 10, footnote 3). That is exactly the principle that should have been applied by the Commission and the Court of Appeals here.

If rate regulation is not to become merely mechanical, some latitude in the rate of return determination is requisite. The Commission ought not to overlook that it must find the rate that is effective unreasonable before it can act further. It ought to be told that it must find that the existing rate produces a return at a rate outside the range of reasonableness before it makes any further determinations. The rule of the *Montana-Dakota* case is important in the field of utility regulation. If it is no longer valid, it is for this Court and not for the Commission to reverse it and proclaim a new rule of law.

3.

The Decision Below Conflicts With the Substantial Evidence Rule

In three instances, the Court of Appeals directed the Commission to state the facts and reasons that led to the

result that it reached. The first of these relates to a matter mentioned above: the use of the income taxes of the Petitioner as a separate entity rather than system income taxes (and thereby reducing permitted revenues by about $190,000), while at the same time rate of return was determined on a system basis. The second relates to the Commission's rejection of the provisions of the contract relating to escalation of the capacity charge. The third relates to the proper rate for the accrual of interest during construction.

In each instance the Court of Appeals directed the Commission to make further detailed findings of fact. In support of its position, the Court of Appeals cited the opinion of this Court in *Colorado-Wyoming Gas Co.* v. *Federal Power Commission*, 324 U. S. 626 (1945), and §8b of the Administrative Procedure Act (5 U. S. C. §1007(b)). Each of these makes it clear that an administrative agency must set out the facts on which it bases its result and the path by which it reaches that result in order for its determination to stand.

The Court of Appeals was clearly right in doing what it did; our complaint is that it did not do enough. It is hornbook law that no determination of an administrative agency can stand unless the record contains substantial evidence to support the determination. The record in this case contains no evidence at all that tends to support the conclusions reached by the Commission. The court had the obligation to examine the record and, upon ascertaining the lack of substantial evidence, to set aside the order of the Commission.

This is an important principle of administrative law. First of all, the Commission ought not to be given a second chance to bolster its erroneous conclusions. But more impor-

tant is the fact that litigation should at some time come to a conclusion. This proceeding has been going on for more than three years. The Petitioner ought not to have to try and retry its case. The Commission ought to reach its conclusions on the basis of the record and ought not to be permitted to patch up the record to support its conclusions. The Court of Appeals has the obligation to examine the record as well as the opinion of the Commission; it should do a complete job of review and not halt when it finds a hiatus in reasoning in the Commission's opinion.

The administrative process, and this is true particularly in rate matters, is a slow one at best. If it is to be further retarded by successive reviews and determinations as courts move a single step at a time, it will surpass the records of the Court of Chancery. If this case goes back to the Commission and it makes the findings that the Court of Appeals directs, the Petitioner will have to bring it to the Court of Appeals again. Then, at long last, it is to be hoped, that court will perform its true judicial function and set aside the Commission's order under the substantial evidence rule.

In order that important principles as to the functions of judicial review of the administrative process may be revitalized by this Court, this case should be here reviewed.

VIII.

CONCLUSION

This case is of great significance to the intelligent regulation of the electric utility industry. On it depends the answer to the question whether or not regulation by the Commission means complete domination. On it depends the answer to the question of whether or not economic

cooperation and development between utilities are feasible. If the Commission is right, contracts between utilities for the coordination of regional economic development will disappear. Each utility will remain isolated in its service area. Each will find it advisable to pay more for individual development than to risk the hazards of Commission intervention in cooperative development. Customers will then pay more for electricity.

Reasonable contracts between non-affiliated utilities are in the public interest. This Court should tell the Commission that its power to interfere is limited rather than absolute.

The writ applied for should be awarded.

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Dated December 31, 1957

APPENDIX A

Opinion of the United States Court of Appeals for the Fourth Circuit

Opinion of the United States Court of Appeals for the Fourth Circuit

Before PARKER, Chief Judge, and SOPER and SOBELOFF, Circuit Judges.

SOPER, Circuit Judge:

South Carolina Generating Company and the South Carolina Public Service Commission filed these petitions for review of an order of the Federal Power Commission reducing rates on the wholesale purchase of electric energy established in a long-term contract negotiated at arm's length in interstate commerce between the Generating Company, the selling utility, and the Georgia Power Company, the purchasing utility.

The Generating Company is a South Carolina corporation formed to construct and operate a steam electric generating station known as Plant Urquhart, located near North Augusta, South Carolina, on the Savannah River. The Urquhart plant as originally built had a rated capacity of 150,000 KW made up of two 75,000 KW generators. The entire capital stock of the Generating Company is owned by the South Carolina Electric and Gas Company (E & G), a South Carolina electric utility, which distributes and sells electric energy in a large area of South Carolina. Georgia Power Company (Georgia Company), an intervenor here, generates and distributes energy throughout the State of Georgia. The South Carolina Public Service Commission is charged with general utility regulation within South Carolina; its counterpart in Georgia is the Georgia Public Service Commission, a respondent in both cases.

E & G, in common with most other utilities in the electric

power industry, experienced a substantial increase in business during the post-war years, and during this period had frequently been confronted with the necessity of adding to its generating capacity. In the summer of 1950, plans were being studied for the purpose of locating additional facilities for E & G in its service area in the western central portion of the state, special consideration being given to a site near Brancheville, South Carolina, and certain plant equipment was on order for delivery in August, 1952. Before final plans were completed and a definite site chosen, the Atomic Energy Commission announced that the Savannah River Hydrogen Bomb Project would be located about fifty miles west of the Brancheville site under consideration. The location of the Project in E & G's service area would be of substantial economic benefit to the utility, since the Project would require large quantities of dependable energy and would bring with it additional commercial and residential consumers. Accordingly, E & G advised E. I. du Pont de Nemours and Company, prime contractor for the A.E.C., that it was prepared to construct additional facilities in the area of the proposed Project which could supply the A.E.C.'s power requirements. The initial rates proposed by E & G during negotiation were rejected by du Pont as excessive. Lower rates, however, would have been impossible under conventional utility financing, since E & G's mortgage, like most utility mortgages, restricted bonded indebtedness to 60 per cent of the total of any property additions. Money to finance the proposed power facilities was needed at a low cost in order to make possible the low rates required by du Pont. To overcome this obstacle, the Generating Company was formed by E & G for the purpose of financing construction of the steam generating station at Urquhart, which could supply the required ca-

pacity to A.E.C. The new corporation was financed on a debt ratio of 90 per cent—75 per cent in mortgage bonds, 15 per cent in ten-year notes, and the remaining 10 per cent in common stock which was purchased by E & G. This high debt financing provided money at a low cost and made possible lower rates to A.E.C., and consequently, du Pont agreed to accept a capacity of 30,000 KW from one of the generating units to be constructed at the new plant. The financing of the Generating Company was made possible by certain commitments and guarantees of E & G hereinafter more fully described.

The Georgia Company at about the same time was also in need of additional power and was contemplating the construction of a one unit steam station near Augusta, Georgia, on the Savannah River across from the Urquhart site. Officials of E & G notified the Georgia Company of their plans to build the two unit 150,000 KW capacity at Urquhart, financed through the Generating Company. Both utilities instituted independent cost studies to determine whether the cost of purchasing the required capacity for the Augusta area from the Generating Company would result in savings to the Georgia Company over the costs entailed in constructing their own facilities to supply the additional capacity. Thereupon, on November 19, 1951, after some negotiation, a long-term contract for the sale of the capacity of one of the 75,000 KW units to be built at the Urquhart plant was entered into between the Georgia Company and the Generating Company. On the same day, E & G contracted to purchase the remainder of the capacity of the other unit not required by the A.E.C., amounting to 45,000 KW. Nearly a year and a half later, on March 9, 1954, after the Urquhart plant was put into operation, du Pont executed a contract with the Generating Company for

the purchase of 30,000 KW to which E & G was made a party.

The Georgia Power contract, the one in issue here, is for a period of twenty-five years, and provides for a two-part rate consisting of an energy charge and a capacity charge. The energy charge, which is not in dispute, is based upon fuel and maintenance costs plus taxes not related to income and is established initially in the contract at the rate of $.00315 per KWH. The capacity charge, computed on a KW basis, is divided into three components. The first is a finance component designed to provide interest and amortization of the 90 per cent debt in twenty-five years and an 8 per cent return on equity, and results in a figure of $10.50 per KW per annum. The second is an operations component including operating, administrative, and general expenses not included in the energy charge, which amounts to $4.80 per KW per annum. The total of these components constitutes the basic capacity charge of $15.30 per KW per annum. To this basic capacity charge is added the third component, a fixed charge of $7.20 per KW per annum, which does not relate to any costs on the books of the Generating Company but was designed to divide equally between the Generating Company and the Georgia Company the savings accruing to the Georgia Company from the agreement as compared with the costs of construction and operation of a generating station of its own. Thus, the contract provides for a total capacity of $22.50 per KW per annum.

The net savings to the Georgia Company as a result of this contract were estimated at $5.38 per KW per annum in capacity costs, or a total of $403,500.00 per annum. Annual savings in respect of the fuel or maintenance were estimated at between $175,000.00 and $200,000.00. Thus

total savings to the Georgia Company through the purchase of its requirements from the Generating Company amounts to approximately $600,000.00 each year.

Among the other provisions of the contract is an article which subjects the capacity charge to an escalation formula for variations between the estimated and the actual investment and between the estimated and the actual expenses and taxes. Similar provisions are made in regard to the energy charge. In addition, a "recapture clause" provides that upon twelve months' notice the Generating Company may reduce the total contract capacity of the Georgia Company by 25,000 KW, and on thirty months' notice it may terminate the agreement and recapture the entire contract capacity. In the event of an outage of one of the two units at Plant Urquhart, the Georgia Company is guaranteed by the contract one-half of the capacity of the remaining unit (37,500 KW).

The du Pont contract, like the Georgia Company contract, provides for a basic capacity charge of $15.30 per KW per annum, but contains an additional fixed charge of only $3.70 per KW, resulting in a total capacity rate of $19.00 per KW per annum. The contract with the parent company, E & G, provides for a total rate of $15.30 per KW per annum with no additional fixed charge. Both contracts have escalation provisions similar to that contained in the Georgia Company contract, but neither the du Pont nor the E & G contract contains a "recapture" provision. To secure the power requirements of the A.E.C. the parent company, E & G, was made a party to the du Pont contract, along with the Generating Company, and gave certain performance guarantees to du Pont. It was necessary for E & G to make improvements on its transmission system to insure high quality service. In addition, A.E.C.'s require-

ments of 30,000 KW are guaranteed by E & G in the event of an outage of one or both of the units at Plant Urquhart, except in a situation where an outage of both units occurs through a force majeure.

The Georgia Power contract, the only one of the three within the jurisdiction of the Federal Power Commission, was filed with the Commission and accepted for filing on October 1, 1953. On October 29, 1954, an order was issued by the Commission initiating a proceeding whereby the Generating Company was required to make a showing of facts necessary for the Commission to determine whether or not the rates agreed upon with the Georgia Company were just, reasonable and non-discriminatory. A hearing was held and testimony was taken. In addition to the testimony of expert witnesses supporting the fairness of the contract on behalf of the Generating Company, officials of the Generating Company, E & G, and the Georgia Company testified as to the advantages of the contract to both contracting parties. Two witnesses testified on behalf of the Federal Power Commission. Representatives of the South Carolina Public Service Commission entered an appearance expressing approval of the contract, while a representative of the Georgia Public Service Commission took the position before the Commission that the contract was discriminatory and unfair. The Presiding Examiner, in a written report, upheld the contract as not unjust, unreasonable or discriminatory. The Commission staff filed exceptions to the examiner's report and oral argument was heard. The Commission, one Commissioner dissenting, set aside the findings of the Presiding Examiner, taking the view that the contract rate would provide revenues to the Generating Company in excess of the cost of service, including a fair return upon the amount prudently invested.

Accordingly, the Commission made the finding that the contract rate for service to Georgia Power was in excess of a just and reasonable rate and was unjust and unreasonable, and reduced the rate from $22.50 per KW per annum to $21.948 per KW per annum, and also nullified the escalation provision as applied to the capacity charge.

The principal attack upon the order of the Commission is directed against its power to set aside the rate fixed by the contract between the utilities and to impose a new rate based upon the cost of service designed to produce a fair return upon the amount prudently invested. It is pointed out that the contract between the Generating Company and the Georgia Power was negotiated at arm's length and was advantageous to both parties. It enabled the corporate system, composed of E & G and the Generating Company, to secure a needed source of additional power and to sell at wholesale a portion of the product at substantial profit, and to use the remainder to supply its consumers in South Carolina at reasonable terms. At the same time, the arrangement furnished Georgia Power a dependable source of energy at a cost much less than would have been incurred by building an additional plant, so that its retail consumers in Georgia were also benefited. Hence it is said that the Commission was obliged to approve the contract and had no power under the Federal Power Act to substitute a lower rate based upon the cost of service, even though it would produce a reasonable return upon the amount invested.

The contention is based upon the companion decisions of the Supreme Court in *United Gas Co.* v. *Mobile Gas Corp.*, 350 U. S. 332, and *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. 348, in both of which the Court set aside an order of the Federal Power Commission raising the rate for supplying energy prescribed in a contract between the utilities. In the *Mobile* case the question arose

under §§4(c), (d) and (e) and §5(a) of the Natural Gas Act, 15 U. S. C. §717, et seq., which gives the Federal Power Commission supervision of the rates of natural gas companies. The case involved a long-term contract between a natural gas pipe line company and a distributing company. The contract fixed a substantially lower rate for gas to be supplied to a particular consumer than was charged for other gas. The purpose was to induce a manufacturer of cement to build a plant in Mobile. Subsequently the pipe line company, without the consent of the distributing company, filed new schedules more closely approximating the rates charged for the gas furnished to other consumers and the new schedules were put into effect with the consent of the Commission. This action was disapproved by the Supreme Court, which held that the Natural Gas Act did not give natural gas companies the right to change their contracts unilaterally, and that the Commission had no power to modify the contract rate unless it should find it would be "unjust, unreasonable, unduly discriminatory or preferential" under §5(a) of the statute.

The *Sierra* case arose under §§205(c), (d) and (e) and §206(a) of the Federal Power Act, which are substantially similar to the corresponding sections of the Natural Gas Act. There was involved a contract for the supply of electric power by a producer to a distributor at a special low rate which was fixed to forestall competition from another source. Later, when power from this other source was no longer available, the producer filed a new rate with the Commission increasing the cost to the distributor by 28 per cent and the Commission approved the new rate after finding upon investigation that it was not unjust, unreasonable, unduly discriminatory or preferential. Assuming that this finding was equivalent to a finding that the contract rate was unreasonable, the Supreme Court nevertheless set

aside the order of the Commission, since it did not appear that the old rate was so low as to affect adversely the public interest.

From the discussion in the *Mobile* case we learn that the Commission is not empowered by the Natural Gas Act to fix the rates initially. Under the statutory scheme all rates are established initially by the utilities, by contract or otherwise, and all rates are subject to modification by the Commission upon a finding that they are unlawful. The basic duty is imposed on the utility by §§4(c) and (d) of the Gas Act (and by §§205(c) and 205(d) of the Power Act) of filing with the Commission rate schedules and contracts in force and all changes in such schedules. This scheme differs from that prescribed by the Interstate Commerce Act, under which all rates to shippers must be uniform and no provision for individual contracts is made. The basic powers conferred upon the Commission by §§4 (e) and 5(a) of the Gas Act (and §§205(e) and 206(a) of the Power Act) are to review the rates and contracts made in the first instance by the utilities and, if they are found to be unlawful, to determine a just and reasonable rate to be thereafter observed.

It was held that this procedure precludes a producer from changing contracts unilaterally to serve its own private interest, but affords an avenue of relief when the interest of the producer coincides with the public interest. In such case the utility has the right to complain and ask the Commission to investigate the rate, and if it finds after hearing that the contract rate is so low as to conflict with the public interest, it has authority to increase the rate.

In the *Sierra* case, the Commission made a similar ruling for the same reason and, in addition, it made a ruling by which the utilities in the pending case set great store. The Court pointed out again that the Commission has undoubted

power to change a contract rate and to prescribe a new rate to be thereafter observed if it determines the old rate to be unlawful, but the Court added that a contract rate is not invalid solely because it yields less than a fair return on invested capital. The Court said, page 355:

> "* * * while it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain. Cf. *Arkansas Natural Gas Co.* v. *Railroad Comm'n*, 261 U. S. 379. In such circumstances the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest — as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory. That the purpose of the power given the Commission by § 206(a) is the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in § 201 of the Act that the scheme of regulation imposed 'is necessary in the public interest.' When § 206(a) is read in the light of this purpose, it is clear that a contract may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility."

It is now contended that these rulings demonstrate that the Commission had no power to set aside the agreed rate and to impose a new rate based on the cost of service in accordance with the orthodox methods of rate making in utility cases. It is argued very strongly that the contract

was beneficial to the South Carolina area, since it furnished the E & G system with an adequate supply of energy under advantageous terms and thus enabled it to serve its South Carolina consumers at a reasonable cost, and also was beneficial to the Georgia area, since it furnished the Georgia Power Company with energy at a cost below that which a plant of its own would have entailed and enabled it to serve its retail consumers at a reasonable cost. Hence it is said that the contract did not adversely affect the public interest.

The argument seems to have great logical force but on examination it soon appears to be an attempt to generalize from a particular situation without recognizing the significant difference in the facts in the pending case. The Supreme Court was dealing with rates, too low to permit an adequate return according to accepted standards, which had been adopted to serve the interest of the producing utilities—in the Sierra case for the purpose of cutting off competition—but the public interest was served by the lower cost to the ultimate consumers. The practical effect of the decision is to compel contracting utilities to abide by their agreements unless it is shown that the agreed rate is so low "as to impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." These quoted clauses form the cornerstone of the utilities argument, but it is plain that they are directed to rates too *low* to be ordinarily imposed.

In the pending case, to the contrary, we are dealing with a rate that was too high according to accepted standards of rate regulations. When the rate was filed the Commission had the power under § 205(e) of the statute to enter upon a hearing on its own initiative concerning the lawfulness of the rate; and in doing so it obviously acted within the scope of its authority. Consequently, the primary question

before us is not whether the Commission had the power to act but whether its finding that the contract rate was unreasonable was supported by substantial evidence on the whole record. See the review provisions of the Federal Power Act, 16 U. S. C. 825 *l* (b), and the related provisions of the Administrative Procedure Act, 5 U. S. C. §1009. The case before us comes down to the inquiry whether the utilities were justified in retaining for themselves the savings inherent in a situation which developed in 1950 and led to the organization of the Generating Company. At that time the pressing need for more power, felt by E & G, the Georgia Power Company, and the Atomic Energy Commission, culminated in an arrangement which was beneficial to all concerned. Undoubtedly the successful solution was due in large measure to the experience and enterprise of the interested parties, but it does not follow that they were entitled to all of the savings which actually flowed from the natural growth and economic development of the area. The problem presented to the Commission was not substantially different from that which usually arises when a public utility, by the force of circumstances a natural monopoly, seeks to furnish a commodity to the general public; the reasonableness of its proposed rate must be considered, and the answer is found by allowing a reasonable return upon the investment.

We do not think that the Supreme Court denounced this accustomed procedure in the *Mobile* and *Sierra* cases when it concluded that the unusually low rates which the utilities had voluntarily set up to serve their own interests were not unjust or unreasonable; and hence the Commission in the pending case, bearing in mind that its duty is to protect the public interest as distinguished from the private interest of the utilities, and finding that the contract rate is unreasonably high was justified in fixing a lower rate

for the benefit of the retail consumers in Georgia after providing a reasonable return on the moneys invested by the utilities.

It is objected that the reduction of rates may not benefit the Georgia consumers since it may lead the E & G system to exercise the option granted it by the contract on twelve months' notice to reduce the contract demand of Georgia Power by 25,800 KW and on thirty months' notice to terminate the agreement and recapture the entire capacity. There is, however, no indication at present that such a step is contemplated and if an attempt should be made in the future, notice of the change would necessarily be filed with the Commission which would then have the opportunity to consider what should be done under the changed situation. In the meantime, its present order will be effective. See *Pennsylvania Power Co.* v. *F. P. C.*, 343 U. S. 414.

It is also suggested by the South Carolina Public Service Commission that the Federal Power Commission had no authority to alter the terms of the contract, since the State Commission has approved the creation of the Generating Company and the contracts under which it serves the South Carolina consumers. It is obvious, however, that the State Commission is without power to control the decisions of the Federal Power Commission when it is acting within the scope of its authority in a matter involving interstate commerce. *P. U. C.* v. *Attleboro Co.*, 273 U. S. 83; *U. S.* v. *Public Utilities Commission*, 345 U. S. 295, 303, 304.

We come then to consider the specific objections to the conclusions of the Federal Power Commission in the exercise of its power under Sec. 206(a) of the statute to determine the just and reasonable rate to be observed after finding that the contract rate was unreasonable. First, the Generating Company objects to the Commission's action in determining the amount of Federal income taxes that

should be included in the cost of service. The Commission made allowance only for the taxes paid by the Generating Company as a separate corporate entity, and rejected the contention that the allowance should be computed with reference to the system as a whole, since in practical effect the Generating Company is merely a department of a single enterprise for which E & G, the parent company, has furnished the credit and financial backing. The amount of the tax of the Generating Company considered as a separate corporate entity is substantially less than that borne by the system as a whole, according to the computations of the utility. Under the Commission's method the Federal income taxes are $217,434.00 and the State income taxes are $43,854.00, or a total of $261,288.00. If the taxes are calculated on the system as a whole, the Federal income taxes amount to $398,002.00 and the State income taxes to $53,377.00, or a total of $450,379.00.

A striking difference in the debt ratios in the capitalization of the parent and subsidiary companies brings about this result. The Generating Company was purposely capitalized with a 90 per cent debt ratio in order to cut down the costs of financing the enterprise and make possible the sale of electric energy to consumers at a lower price. Accordingly, interest payments on the debt, which are deductible in computing taxable income, are relatively large. On the other hand, the income tax of E & G is relatively high, because it is obliged to maintain a low debt ratio and a high common equity ratio in order to protect its financial standing and secure a favorable market for the system's securities; and the need for a high ratio of common equity as compared with the debt, became greater when the Generating Company was formed. The result was that in 1954, after the new plant had been built, the system capitalization ratio consisted of 62.8 per cent debt, 9.4 per cent preferred

stock, and 27.8 per cent common equity, so that the interest payments of the system as a whole are comparatively small and the income tax comparatively high. The testimony of financial experts on behalf of the company shows that the figures last quoted represent a substantial increase in the common equity over that of the parent company in 1951, before the subsidiary was organized. In order to finance the new company, it was necessary for the parent company to provide funds for investment in the common stock of the subsidiary and also to provide a proportionately larger amount of its new money requirements by the sale of equity securities. In short, it was necessary for the parent company to provide equity leverage for the debt of its subsidiary. The essential part which the parent company played in the organization of the new enterprise is also shown by the various commitments which it made in guaranteeing the payment for equipment as well as payment of the bonds and notes of the subsidiary and, to some extent, the performance of its contracts. For these reasons the utilities contend that the Commission's determination of the amount of revenues that should be allowed to the Generating Company on account of income tax expense should be increased by the sum of $189,091.00.

The Commission takes the position that it should follow its usual rule that the allowance for taxes should not exceed the taxes actually paid, since otherwise the Generating Company would enjoy benefits of high debt financing and the Georgia consumers would assume fictitious costs. The evidence in the case, however, tends to show that the additional costs for which the utility contends are not fictitious but are actually incurred by the system as a whole. Moreover, the action of the Commission seems to be inconsistent with its conclusion that, in fixing the rate of return on the investment of the utility, the capitalization of the system as a

whole should be used. In its conclusion on this point, the Commission said:

> "Applying the rates found reasonable for debt, preferred stock, and common equity, and using the system capitalization ratio of 62.8%-9.4%-27.8%, we arrive at an allowance for over-all rate of return of 5.55%."

The Commission does not explain in its opinion why the technical distinction between the two corporate entities is observed in determining the allowance for income taxes, while for the purposes of fixing the rate of return on the investment the system is considered as a single enterprise.

The apparent inconsistency may be reconciled, or justified, by reasons that do not occur to us. No reasons are advanced in the Commission's opinion, if in fact reasons exist. In these circumstances, in deference to the Commission's primary function, we are reluctant to draw an inference of arbitrariness without affording an opportunity for further explanation. On the other hand, a reviewing court cannot perform its proper function when the regulatory body has failed to make adequate exposition of the grounds for its action. We realize the limits upon the scope of judicial review of rate orders, as taught in *Hope Natural Gas* v. *Commission*, 320 U. S. 591. But in a later case, *Colorado-Wyoming Co.* v. *Commission*, 324 U. S. 626, 634, the Supreme Court set aside an order of the Federal Power Commission, and speaking through Mr. Justice Douglas, as it had done in the *Hope* case, said: "We have repeatedly emphasized the need for clarity and completeness in the basic or essential findings on which administrative orders rest. Their absence can only clog the administrative function and add to the delays in rate making." The same section of the Administrative Procedure Act (Sec. 8b, 5 U. S. C. 1007

(b)), which calls for findings of fact, requires with equal force "a statement of the *reasons* or basis therefor, upon all the material issues of fact, law or *discretion* presented on the record." [Emphasis added.] This case must therefore be remanded for a fuller explanation as to the different treatments of capitalization ratio and allowance for income taxes.

The Generating Company makes the additional contention that the rate of return should be 6 per cent and not 5.55 per cent as allowed by the Commission. The difference in money return on the amount of the investment found by the Commission approximates $57,000.00 per annum. For its position the Generating Company relies primarily on the testimony of an experienced investment banker familiar with the financial background of the E & G system and the marketing of utility securities. He was of the opinion that 6 per cent was necessary to assure the successful financing of the system in the near future, basing his opinion in large measure on a theoretical capitalization ratio of 50 per cent debt, 15 per cent preferred stock, and 35 per cent common equity which he considered the setup that the company should ultimately maintain.

The Commission, on the other hand, based its determination on the cost of capital, using the actual capitalization ratios of the system. Testimony as to the cost of the debt and of the preferred stock given by an expert witness was accepted by the Commission and his estimate of the cost of the equity capital was raised from 7.9 per cent to 10.5 per cent so as to take into account the relative thinness of the equity capital, the upper trend of the money market, and other conditions.

The company concedes that a cost of capital study is a recognized means of arriving at a rate of return but it contends that the Commission's conclusions were not sup-

ported by the testimony, because its expert witness failed to express an opinion as to what the rate of return should be. It is said that the Commissioners are not financial experts and are therefore not entitled to take the evidence and to draw an expert conclusion therefrom. This position is at variance with a decision of the Supreme Court in *Market St. Ry. Co.* v. *Railroad Commission of California*, 324 U. S. 548, where the Court held that an order of the Commission fixing a rate of return was not unsupported by the evidence and rendered invalid by the fact that the Commission evaluated the situation without the aid of expert testimony. Under these circumstances the finding of the Commission on this point should not be disturbed.

The Generating Company also objects to the finding of the Commission that the automatic escalation clause of the contract, providing for adjustment of the basic capacity charge, is unjust and unreasonable. The clause is designed to increase or decrease the capacity charge in case of variations between the estimated and the actual amount of investment and of expenses of operation of the plant. Similar provisions are made in regard to changes in the energy charge. The Commission retained a provision for automatic escalation of the capacity component in respect to future changes in the rate of Federal income taxes and also retained the escalation provisions in regard to the energy charge. It gave no reason for its action other than to make the general finding that the escalation provisions of the basic capacity charge are unjust and unreasonable and in contravention of § 205 of the statute and § 35.3 of the Commission's regulations. We recognize that the retention or elimination of such a clause is a matter for the determination of the regulatory body upon findings of fact. In the absence of such findings, however, we think the question

should be re-examined by the Commission upon the remand of the case.

The amount allowed the utility for interest during construction is also the subject of objection on the part of the Generating Company. The examiner found upon uncontradicted evidence that the equity funds used by the parent company during construction cost approximately 10 per cent. He allowed 8 per cent for the purpose of inclusion in the rate base but the Commission reduced this amount to 6 per cent, which it held was reasonable and consistent with its past practice. The Commission does not make clear why this actual expense, which was involved in the construction of the plant, should not be considered a part of the investment on which a reasonable return should be allowed. In its opinion it declares that the Generating Company should not be permitted to capitalize profits on investment before commercial operation of the plant has begun. This may be true, but it does not explain why an element of cost actually experienced should not be included in the rate base. Accordingly this matter should also be examined on remand so that the Commission may make adequate findings in explanation of its determination.

Objection is also made to the Commission's allowance of a 3 per cent annual rate of expense depreciation. The utility offered evidence in support of this rate and the examiner adopted it in his computation. The Commission however reached the conclusion that a 2.75 per cent rate was adequate for this purpose. This conclusion is not without support in the evidence. The 2.75 per cent rate had been used by the E & G company for many years on substantially similar property and was also used by one of the company's witnesses in a study presented to the Commission's staff: but a shift to 3 per cent seems to have been

made for the purpose of the hearing. Under these circumstances it can not be said that the determination of the Commission was without substantial basis in the evidence.

The order of the Commission will remain suspended and the case remanded for further proceedings as indicated in this opinion.

PARKER, Chief Judge, Concurring in Part and Dissenting in Part:

These are petitions to review an order of the Federal Power Commission reducing rates on electric energy furnished by the South Carolina Generating Company to the Georgia Power Company pursuant to a long term contract which prescribed the rates. There is no question but that the energy was furnished in interstate commerce. The order is attacked on the ground that the Commission was without power to enter the order in the absence of a finding that the contract rates will result in impairing the ability of one of the parties thereto to render public service or will impose an excessive financial burden upon its customers, and upon the further ground that the rates prescribed by the order are not supported by the record before the Commission. I cannot think that either ground of attack can be sustained. The facts may be briefly summarized as follows:

The Generating Company is a wholly owned subsidiary of the South Carolina Electric and Gas Company, hereinafter referred to as E & G, which is engaged in generating and distributing electric energy in the State of South Carolina and which in 1950 was contemplating an addition to its generating capacity. About that time the construction of the Hartwell Reach Project in South Carolina by E. I.

duPont de Nemours and Company was commenced and the Generating Company was organized by E & G to supply the electric energy required by the project, a separate corporation being organized because of the restriction which existed on the amount of E & G's mortgage indebtedness and the necessity of acquiring additional capital for the new construction at a low rate if the energy was to be supplied to duPont at a rate to which duPont would agree. The Generating Company was accordingly financed on a ratio of 90% debt to 10% of common stock, and proceeded to construct at Urquhart on the Savannah River a power plant of 150,000 KW capacity, which was large enough to take care of the needs of E & G and duPont and provide additional energy, which was sold to the Georgia Power Company.

Prior to the construction of the Urquhart plant, the Georgia Power Company, which had been contemplating additions to its own generating system, determined that it could save money by purchasing energy from the Generating Company instead of building an additional plant of its own. It accordingly entered into a twenty-five year contract with the Generating Company by the terms of which that company undertook to furnish and Georgia Power agreed to purchase the full capacity of one of the two 75,000 KW units to be installed by the Generating Company at Urquhart. The 75,000 KW capacity of the other unit was sold to duPont and E & G, 30,000 KW being sold to duPont and 45,000 KW to E & G.

The charge to all three of the customers of the Generating Company, i.e. Georgia Power, duPont and E & G, was divided into an energy charge and a capacity charge. The energy charge is not in dispute. The capacity charge to Georgia Power was $22.50, to duPont $19.00 and to E & G

$15.30. The $22.50 capacity charge to Georgia Power embraced an item of $15.30, corresponding to the capacity charge to E & G and an additional item of $7.20. The $15.30 item was and is made up of two components. The first is a finance component designed to provide interest and amortization of the 90% debt in twenty-five years and an 8% return on equity, and results in a figure of $10.50 per KW per annum. The second is an operations component including operating, administrative, and general expenses not included in the energy charge, which amounts to $4.80 per KW per annum. The remaining $7.20 added to the capacity charge in the rate fixed by the contract with Georgia Power does not relate to any costs on the books of the Generating Company but was designed to divide equally between that company and Georgia Power the estimated savings to Georgia Power from the agreement as compared with the construction and operation of a generating station of its own, the estimated saving being around $600,000 per year. The contract provided for termination on notice, and contained escalation clauses under which both the energy charge and the capacity charge were related to certain costs. Under the escalation clause relating to the capacity charge, that charge to Georgia Power had been increased to $25.11 per KW.

The Commission held that the reasonableness of the rate should be determined by cost of service to the utility furnishing the energy and not by the value of the service to the purchaser, and upon its findings as to the cost of service to the Generating Company ordered that the capacity charge be reduced to $21.948 per KW. It ordered also that the escalation provision for change in the capacity charge be eliminated for the future, except with respect to increase or decrease in the federal income tax rate.

I think that the entry of the order based upon cost of service, and without reference to the use value of the current to the purchaser or the provisions of the contract under which it was furnished, was well within the power of the Commission. The manifest purpose of the Federal Power Act is the regulation of rates for the benefit of ultimate consumers (16 USCA 844(a)), and there can be no question but that the Commission has been vested with ample power of rate regulation to accomplish this purpose. Section 206 (a) of the Act, 16 USCA 824e(a) provides:

> "(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order."

And it is well settled that the Commission is given wide discretion as to the adoption and application of standards in the exercise of the power thus vested in it. In *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 586, the Supreme Court, speaking through Chief Justice Stone, said:

> "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their stat-

utory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. If the Commission's order, as applied to the facts before it and viewed in its entirety produces no arbitrary result, our inquiry is at an end."

And in the later case of *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, 602, the Court, speaking through Mr. Justice Douglas, said:

"We held in Federal Power Commission v. Natural Gas Pipeline Co., supra, that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' Id., p. 586. And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. Id., p. 586. Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. Cf. Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U. S. 287, 304-305, 314; West Ohio Gas Co. v. Public Utilities Commission (No. 1) 294 U. S. 63, 70; West v. Chesapeake & Potomac Tel. Co., 295 U. S. 662, 692-693 (dissenting opinion). It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to

reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. *And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.*" (Italics supplied).

The rate order cannot be held unjust or unreasonable in its consequences on the ground that in prescribing just and reasonable rates based on cost of service it ignores the value of the service to the purchaser, which is the basis of the contract rate. As was well said by the Commission in its opinion:

> "The value-of-service approach advocated by Generating Company would result in a chaotic structure based in part upon the cost to the buyer of supplying substitute power. Such 'regulation' would, in fact, be no regulation at all and would completely disregard the public interest and the ultimate consumer which the Act is designed to protect. Cf. Phillips Petroleum Co. v. Wisconsin, 347 U. S. 672. Mississippi River Fuel Corp. v. Federal Power Commission, 121 F. 2d 159 (C. A. 8, 1941).
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> "The mild prediction by Generating Company that it might exercise the recapture or cancellation provision in its contract unless it is permitted the higher rate only serves to emphasize the importance of our adherence to the cost-of-service test. The manifest purpose of the Act is the regulation of rates for the benefit

of the ultimate consumer. Section 201(a). Federal Power Commission v. Hope Natural Gas Company, 320 U. S. 591. If we were to approve the rate contained in the contract solely upon the basis that the two contracting utilities have struck a bargain, and that one of the parties would cancel the contract unless we did approve it, we would be remiss in our duty to protect the ultimate consumer. Such a rationale could lead only to approval of all contract rates irrespective of the public interest involved contrary to the provisions and purposes of the Federal Power Act."

Petitioners rely particularly upon *United Gas Co.* v. *Mobile Gas Corp.*, 350 U. S. 332 and *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. 348; but there is nothing in either of these decisions that supports their position. They hold merely that rates prescribed by contract cannot be raised by unilateral filing of higher rates in the absence of a finding that the public interest is affected by the lower rates—"as where it might impair the financial ability of the public utility to continue its service",—a consideration which can manifestly have no application to a case where the rates are found to be too high in application of the cost of service principle. That the holding in these cases does not impair the regulatory power of the Commission over contract rates in a case such as this was made perfectly clear by the Supreme Court in the *Mobile Gas case, supra* (350 U. S. at 344), where the court said:

"Our conclusion that the Natural Gas Act does not empower natural gas companies unilaterally to change their contracts fully promotes the purposes of the Act. By preserving the integrity of contracts, it permits the stability of supply arrangements which a[illegible] agree is

essential to the health of the natural gas industry. * * * On the other hand, denying to natural gas companies the power unilaterally to change their contracts in no way impairs the regulatory powers of the Commission, *for the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest.* The Act thus affords a reasonable accommodation between the conflicting interests of contract stability on the one hand and public regulation on the other." (Italics supplied).

There is nothing in the record to sustain a holding that the action of the Commission in fixing the rate in its order is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law" when the cost of service principle is applied.* The attack here clearly relates to matters involving the exercise of the discretion vested in the Commission by Congress; and it is too well settled to admit of argument that as to such matters we may not substitute our judgment for that of the Commission.

The principal contention made in this connection is that, because of the circumstances under which the Generating Company was organized as a subsidiary of E & G, the entire tax deduction to which it is entitled for interest paid on bonded debt should not be deducted in computing its income but only such part as corresponds to its part of the total indebtedness of E & G and its subsidiaries. The effect of this, of course, would be to decrease the showing

* We are authorized to set aside agency "action, findings and conclusions" in a case such as this only where they are found to be "(1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence". 5 USC 1009(e).

of income earned by the Generating Company; but such decreased showing would be contrary to fact and contrary to the established practice of the Commission in such cases. The Generating Company is a corporation separate and distinct from its parent company, E & G, and it is engaged in a separate and distinct business undertaking. The Commission cannot be held to have acted arbitrarily or to have been guilty of an abuse of discretion in holding that the income of the subsidiary, whose rates alone were being reviewed by it, should be computed on the basis of its own operations and expenses without reference to those of the parent company. With respect to this matter the Commission said:

> "With regard to the income tax allowance, Generating Company uses a hypothetical system capitalization ratio instead of its own actual ratio in order to erase the effect of higher tax costs which E & G Co. may incur as a result of the heavy debt financing of Generating Company. This is an attempt to enjoy the benefits of the high-debt financing, i.e., the construction of low cost capacity and the consequent sale to duPont, while making Georgia Power Company and ultimately the consumers in Georgia assume fictitious costs. As such, the allowance proposed by Generating Company is unreasonable.
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> "We have consistently held that the allowance for taxes should not exceed taxes paid. E.G., in the Matters of Michigan-Wisconsin Pipe Line Company, Docket Nos. G-1678 and G-1996, Opinion No. 275, issued July 30, 1954. Accordingly, the income tax allowance in this proceeding should be based upon the actual interest deduction of the Generating Company for that is the basis upon which it will pay its taxes."

And I do not think that the Commission's action in this respect can be held arbitrary or unreasonable or an abuse of discretion because, in determining the rate of return to be allowed on invested capital, it looked to the capital structure of E & G rather than to that of the Generating Company; but, if there is inconsistency between this and the treatment of interest on debt, it does not follow that the determination of the Commission with respect to the treatment of interest is to be condemned. The condemnation would rest rather upon allowing a return upon a greater equity invested capital than the Generating Company actually had. If this was error, however, it was error favorable to the Generating Company of which it cannot and does not complain. Certainly, the Commission cannot be held guilty of abuse of discretion in requiring that the income of the Generating Company be computed with accuracy merely because, in the company's interest, it allowed the rate of return to be based upon the E & G system capital ratio rather than upon that of the company itself.

Other attacks upon the Commission's order merit but brief consideration. The fixing of the rate of return at 5.55%, instead of at 6% as contended by the company, the allowance of 6% interest on funds used during construction, instead of 10%, and the allowance of a depreciation rate of 2.75% instead of 3%,—all of these were peculiarly matters for determination by the informed judgment of the Commission. See *Safe Harbor Water Power Corp.* v. *Federal Power Com'n*, 3 Cir., 179 F. 2d 179, 200-201; *Kansas* v. *Federal Power Com'n*, 8 Cir., 206 F. 2d 690, 713-714; *Market Street Ry. Co.* v. *Railroad Commission of California*, 324 U. S. 548, 559-561. The same is true with respect to the Commission's elimination of the escalation clause from the capacity charge of the contract. It is to be noted that the escalation clause was allowed with respect to the

energy charge, which does not reflect any return on a rate base. As the Commission was not required to adopt any specific formula in determining rates (*Federal Power Com'n* v. *Hope Natural Gas Co., supra*), abuse of discretion could not possibly be predicated of elimination of the escalation clause, which, when applied to the capacity charge, necessarily involves the "cost of reproduction" or the "prudent investment" principle as to some of the matters embraced within the charge. It is well settled that "prudent investment" and "cost of reproduction" are not to be accepted as exclusive tests but are merely matters to be considered in the fixing of rates. *Los Angeles Gas & Electric Corp.* v. *Railroad Com'n of California*, 289 U. S. 287, 304-308.

In considering whether the Commission has abused its discretion in ordering the rate reduction in this case, it must be borne in mind that the basic capacity charge on the sale in interstate commerce to the Georgia Power Company was $22.50 per kilowatt, whereas the charge to duPont was $19.00 and to E & C $15.30.* While the question of discrimination is not before us, these figures were pertinent as bearing upon the reasonableness of the basic capacity rate, which could be sustained as to Georgia Power only on the value of service theory, which the Commission very properly refused to adopt. In the light of the entire record before us, I see no basis upon which the action of the Commission can be said to be "unjust or unreasonable in its consequences" or be set aside as an abuse of discretion. See *Federal Power Com'n* v. *Hope Natural Gas Co., supra*, 320 U. S. 591, 602. I think, therefore, that the decision of the Commission should be affirmed.

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*Even when the duPont charge is increased under the escalation clause to $21.61 per KW, the rate is less than the $21.94 per KW rate prescribed by the Commission for Georgia Power.

APPENDIX B

Sections 205 and 206 of the Federal Power Act (16 U. S. C. §§ 824d and 824e)

Sections 205 and 206 of the Federal Power Act (16 U. S. C. §§824d and 824e)-

Sec. 205. (a) All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No public utility shall with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, services, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or

changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service, shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are

paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Sec. 206. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

(b) The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

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Supreme Court of the United States

OCTOBER TERM, 1957

No. 697

SOUTH CAROLINA GENERATING COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION, ET AL.,
Respondents.

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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Dated February 24, 1958

TABLE OF CONTENTS

Page

I. Introduction 1

II. The Application of Sierra 1

III. The Effect of Montana-Dakota 3

IV. Substantial Evidence 4

V. Conclusion 5

TABLE OF AUTHORITIES

Federal Power Commission v. Sierra Pacific Power Co., 350 U. S. 348 (1956) 1, 2, 3

Memphis Light, Gas and Water Division v. Federal Power Commission (D. C. Cir. November 21, 1957), certiorari granted, October Term, 1957, Nos. 691, 694, 695, February 3, 1958 3

Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U. S. 246 (1951) 3, 4

United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U. S. 332 (1956) 4

I.

INTRODUCTION

The Brief for the Respondent dismisses summarily the principal questions presented to the Court in this case and focusses on the subsidiary question of evidence, a question that of itself would not merit review by this Court. This dismissal includes arguments that seem to us to oversimplify the important questions. For this reason, we present this brief reply.

II.

THE APPLICATION OF SIERRA

The principal question here is what is meant by the simple term "reasonable" in the Federal Power Act in the context of rates established by a valid contract. This Court said, in effect, in the *Sierra*[1] opinion, that, when rates established by arm's-length bargaining between unaffiliated utilities are at issue, the Commission must apply a standard of reasonableness different from that to be applied in the review of rates not fixed by contract. It is not enough, this Court held, that the Commission conclude simply that the contract rates do not coincide with the rates that would result from application of the formula of its predilection; the Commission, in order to annul the contract, must find that substantial economic harm would result to one party or the other from application of the contract. That is because valid contracts can be set aside only when they adversely affect the public interest in a demonstrable manner as exemplified in *Sierra*. That is exactly what the Commission did not and could not find here.

Reasonableness is not an exact standard. It has varying

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[1] *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. 348 (1956).

implications in varying circumstances. One who is authorized to pick the most reasonable choice from a number of alternatives faces a problem quite different from one who is required to determine whether a choice previously selected is reasonable. The Commission has shown here that it does not differentiate between these two problems. Its solution here was to narrow the question by concluding that only a single path could lead to a "reasonable" conclusion. That contravenes its duty. The Commission conceives that the standard of reason is only an expression of its individual opinion; it does not apply it in the tradition of judicial restraint formulated by the courts.

The Commission states that the standard that we urge with the support of the *Sierra* decision can lead only to absolute immunity for contract rates (Brief, pp. 7-8). Its fear is unjustified. It overlooks its power to annul contracts that are unreasonable when the test is the broad band of reasonableness established by this Court. We do not, of course, dispute this power. And utilities are not likely to abuse this broad standard. The basic principles of economic self-interest will preclude it. Two utilities not required by law to provide or accept service between each other will do so only when there are mutual economic advantages. Such mutual advantages undeniably existed here in the form of annual savings to Georgia Power of $600,000 and material help to Petitioner and E. & G. If the burden resulting from the contract on either party becomes unduly heavy, the Commission is authorized to revise the contract rates. But that is the only time for revision and that time has not come in this case.

Furthermore, the Commission attempts to gain support for the decision below from *Sierra* by the bold assertion that both simply provide for lower rates for consumers (Brief, p. 10). But again, we suggest, the question arises as to

designation of the consumers protected, for South Carolina consumers, ably represented here (No. 782), are required by the Commission in effect to pay the award that it has given to Georgia consumers. Nothing is gained in this case by arranging the parties on the side of the angels; there are angels everywhere.

Finally, *Memphis*[2] cannot be dismissed so easily as the Commission would like (Brief, p. 11, footnote 2). That case relates to the *procedure* to be applied in respect of changes in contract rates; this case relates to the *standard* to be applied in determining the legality of changes in contract rates. Both raise important questions of administrative law. *Memphis* holds that a different procedure is required when contract rates are reviewed from that to be followed when filed rates are examined. *Sierra* holds that a different standard for review applies to contract rates from that applicable to filed rates. The Commission does not like the *Sierra* rule, for the rule fetters its dominion: it has evaded it here. Unless both the *Memphis* case and this case are reviewed by this Court, the status of contract rates will remain uncertain. Since this Court has agreed to consider that phase of the problem presented by *Memphis*, it would be most appropriate to clear up here the other phase left uncertain now that the *Sierra* rule has been undermined by the decision below.

III.

THE EFFECT OF MONTANA-DAKOTA

The Commission says: when a commission fixes rates, a reviewing court can upset them only when it finds them

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[2] *Memphis Light, Gas and Water Division* v. *Federal Power Commission* (D. C. Cir. November 21, 1957), certiorari granted, October Term, 1957, Nos. 691, 694, 695, February 3, 1958.

outside the zone of reasonableness; but when utilities fix rates by contract, a reviewing commission may upset them when they are *within* the zone of reasonableness. At least that is the only conclusion that we can draw from the argument of the Commission (Brief, p. 10).

So stated, the argument is patently absurd. We assume that the Commission would not now argue that its duty here is to fix the contract rates; it does not fix rates.[3] It performs a more expanded function than a reviewing court, for it hears evidence and finds facts. But we suggest that the legal standard of reasonableness to be applied is the same, whether applied by court or commission. The Commission cannot simply close its eyes to the *Montana-Dakota*[4] "band of reasonableness" rule as it would like to do. The rule applies here, especially as to contract rates, and the Commission simply did not follow it.[5]

If *Montana Dakota* is to retain any substance at all, this case should be reviewed and the action of the Commission reversed.

IV.

SUBSTANTIAL EVIDENCE

Strangely enough, the Commission devotes the greater part of its argument to the rather subsidiary questions arising under the substantial evidence rule (Brief, pp. 12-18). A detailed answer is not appropriate here, though we note

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[3] *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U. S. 332 (1956).

[4] *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U. S. 246 (1951).

[5] It will not do to say at this late date that application of the rule would not have led to a different result (Brief, pp. 11-12). The computations made by the Commission are merely exercises in arithmetic and do not, in our opinion, accurately reflect findings that would have had to be made by the Commission had it sought first to determine whether the contract rates were within the zone of reasonableness.

that not a single record reference to evidence is given.

The Commission does not find any substantial evidence to support its findings. There was, for example, evidence of record that the cost of equity funds was 10% (II. 155-7). The Petitioner sought interest during construction on equity funds only at the reduced rate of 8% (II. 185). The Commission allowed the "generous" rate of 6% (Brief, p. 17). But what evidence is there that 6% is "generous"? There is not a word of record, and the Commission does not even assert that there is. This is merely an example of how far the Commission strayed into the field of expertise.

The Commission should be required to base its decisions on evidence and not on its preconceived notions of propriety.

V.
CONCLUSION

The Brief for the Respondent merely emphasizes the importance of review in this case. The writ applied for should be awarded.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1957

SOUTH CAROLINA GENERATING COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute involved	2
Statement	2
Argument	7
Conclusion	18

CITATIONS

Cases:

Federal Power Commission v. *Natural Gas Pipeline Co.*, 315 U. S. 575 — 10, 11

Federal Power Commission v. *Sierra Pacific Power Co.*, 350 U. S. 348 — 7, 8, 9, 10

Memphis Light, Gas and Water Division, et al. v. *Federal Power Commission* (C. A. D. C. No. 13666, decided November 21, 1957), pending on writs of certiorari, Nos. 691,694, 695, this Term — 11

Montana-Dakota Utilities Co. v. *Northwestern Public Service Co.*, 341 U. S. 246 — 10

State Corporation Commission of Kansas v. *Federal Power Commission*, 206 F. 2d 690, certiorari denied, 346 U. S. 922 — 18

United Gas Pipe Line Co. v. *Mobile Gas Service Corp.*, 350 U. S. 332 — 7, 8

Miscellaneous:

Federal Power Act, 49 Stat. 838, 16 U. S. C. 791a, *et seq.*:

Section 205 — 8, 19

Section 206(a) — 9, 21

Natural Gas Act, 15 U. S. C. 717c, Section 4 — 8

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OPINIONS BELOW

The opinion and orders of the Federal Power Commission (1 R. 93–120, 135–139)[1] are reported at 16 F. P. C. 52 and 1365. The opinions of the United States Court of Appeals for the Fourth Circuit (Pet. App. A 1–30) are reported at 249 F. 2d 755.

JURISDICTION

The judgment of the Court of Appeals was entered on October 23, 1957. A petition for rehearing, timely filed, was denied on November 23, 1957. The petition for a writ of certiorari was filed on December 31, 1957. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

[1] Petitioner filed the record in six volumes. Thus, 1 R. — refers to the first volume.

QUESTIONS PRESENTED

1. Whether the Federal Power Commission, acting pursuant to Section 206 (a) of the Federal Power Act, may reduce a contract rate when it finds that the rate is unjust and unreasonable on the basis of cost of service.

2. Whether the concept of a zone of reasonableness applies to the Commission's review of contract rates which are found to be in excess of the cost of the service (including a fair return on investment).

3. Whether there is substantial evidence to support the three findings that the Commission has been instructed by the court below to explain in greater detail on remand.

STATUTE INVOLVED

The pertinent provisions of the Federal Power Act, 49 Stat. 838, 16 U. S. C. 791a, *et seq*, are set out in the Appendix, *infra*, pp. 19–21.

STATEMENT

Petitioner, South Carolina Generatin ; Company, is a wholly-owned subsidiary of South Carolina Electric & Gas Company (E & G), which was formed for the purpose of financing the construction of Plant Urquhart steam electric generating station. In 1950, E & G, which distributes and sells electric energy within the state of South Carolina, was considering an addition to its generating capacity and was investigating possible sites for location of a steam plant. Before final plans were completed and a definite site chosen, the Atomic Energy Commission announced that its Savannah River Hydrogen Bomb

Project would be located in the vicinity of Aiken, South Carolina. Sensing the possibility of the addition of a major increase in demand in its market area, E & G entered into negotiations with E. I. duPont de Nemours & Company, as prime contractor for the Atomic Energy Commissions at Aiken, to supply electric energy to the installations at Aiken. Originally, E & G planned to construct the new capacity itself and made an initial offer to duPont based upon that assumption. However, the proposed rate was rejected by duPont as too high. Since lower rates would have been impossible under conventional utility financing and because of the restriction which existed on the amount of E & G's mortgage indebtedness, E & G formed petitioner, a wholly owned subsidiary having a capital ratio of 90 percent debt to 10 percent common stock, the stock being held by E & G. This high debt financing provided money at a low cost and made possible lower rates to duPont, which agreed to accept a capacity of 30,000 kw. (1 R. 94–95).

Prior to the construction of the Urquhart plant, the Georgia Power Company, which had been contemplating additions to its own generating system, found that it could save money by purchasing power (capacity) and energy from petitioner instead of building an additional plant of its own. Accordingly, it entered into a twenty-five year contract with petitioner by the terms of which petitioner undertook to furnish, and Georgia Power agreed to purchase, one-half of the capacity of the two 75,000 kw units

to be installed by petitioner at Urquhart. The remainder of the capacity was sold to duPont and E & G, 30,000 kw to duPont and 45,000 kw to E & G (1 R. 95–96). Only the sale to Georgia Power is subject to Federal Power Commission jurisdiction.

Petitioner's contracts with its three customers, Georgia Power, E & G, and duPont, contain similar provisions but varying rates. Each contract provides for a two-part rate consisting of an energy charge and a capacity charge. The energy charge, about which there is no dispute, is based on fuel and maintenance costs plus taxes not related to income. The capacity charge in each case includes a basic rate of $15.30, subject to escalation. This $15.30 charge includes a component of $10.50, representing interest, amortization of the debt and return at 8 percent on equity; and a component of $4.80, representing expenses related to the ownership of the Urquhart Station. To this basic $15.30 charge there is added a fixed charge of $7.20 per kw in the Georgia Power contract, a fixed charge of $3.70 in the duPont contract, but no additional charge in the contract with the parent company, E & G. Thus, the original capacity charge to Georgia Power was $22.50 per kw, to duPont $19.00 per kw, and to E & G $15.30 per kw. As adjusted to reflect increased plant cost in accordance with escalation clauses in each contract, petitioner estimated that for the test year 1956 the capacity charge would be $25.31 for Georgia Power, $21.81 for duPont, and $18.11 for E & G. (1 R. 96–97).

The $7.20 added to the capacity charge in the rate fixed by the contract with Georgia Power does not relate to any costs incurred by petitioner but was designed to divide between petitioner and Georgia Power the estimated savings to Georgia Power from the agreement, as compared with the construction and operation of a generating station of Georgia Power's own, the estimated saving being about $600,000 per year. The Federal Power Commission also noted that, although duPont pays less per kw of capacity than Georgia Power, duPont receives superior service which costs more to provide (1 R. 97–98).

After petitioner's contract with Georgia Power was filed as a rate schedule with the Federal Power Commission, the Commission undertook an investigation to determine whether this contract rate was unjust, unreasonable, or unduly discriminatory (1 R. 94). The Commission held that the reasonableness of the rate should be determined by cost of service to the utility and not by the value of the service to the purchaser (1 R. 98–102). On the basis of its findings as to the cost of service to petitioner, the Commission found that the contract rate for service to Georgia Power was in excess of a just and reasonable rate by $252,186 annually, and was unjust and unreasonable. Accordingly, it ordered that petitioner's capacity charge to Georgia Power be reduced from $25.31 per kw (or $1,898,300) to $21.95 per kw (or $1,646,114), a difference of $252,186 per year (1 R. 116–117). It also ordered that the escalation pro-

visions in the capacity charge be eliminated for the future, except with respect to increase or decrease in the federal income tax rate (1 R. 117).

On petition for review of this order, the court below unanimously held that the entry of the Commission's order based upon cost of service, and without reference to the value of the services to the purchaser, was within the power of the Commission. The court also found that the record supported the Commission's action allowing a rate of return of 5.55 percent rather than the 6 percent sought by petitioner, and a depreciation allowance of 2.75 percent instead of the 3 percent sought. But the majority of the court found that the Commission had failed to explain three findings in sufficient detail and ordered the proceeding to be remanded to the Commission. The court thought the Commission should explain why it used petitioner's actual capitalization ratio in determining its income taxes while using the capitalization ratio of the entire E & G system in fixing the rate of return on investment. The Commission was also instructed to explain its reasons for eliminating the escalation provisions from the basic capacity charge and for allowing interest of only 6 percent for the use of equity funds during construction. Chief Judge Parker, finding that the Commission had not abused its discretion in any respect, voted to affirm the Commission's order in its entirety.

ARGUMENT

1. Petitioner urges that, because it entered into a rate contract with the Georgia Power Company at arm's length, the Federal Power Commission is without authority to change these contract rates without finding that the rates and charges to the purchaser (Georgia Power) are so high as to impair its financial ability to render service to its customers, to cast an excessive burden on its customers, or to be unduly discriminatory. As was found by both the Commission and the unanimous court below, this contention is based on a totally unwarranted interpretation of this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U. S. 332 and *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. 348, 355, as requiring that there be added to the findings which the Commission must make, in order to reduce a contract rate found excessive, the further finding that the excess would also adversely affect "the financial ability of the public utility" purchasing the power "to continue its service." Indeed, it is apparent that acceptance of this contention would result in allowing two utilities to set any rate they choose by agreement, perhaps on the value-of-service principle as here, or any other basis. The Commission would ordinarily not be able to find that the rate was so excessive as to prevent the purchasing utility from continuing to render service, since the latter can pass along the higher rates it pays in the rates it charges. Thus, contrary

to the explicit language in both of the cases relied on, such rates would in fact be immune from regulation.

In both the *Mobile* and *Sierra* cases, this Court was concerned with a unilateral rate increase filed by the seller in derogation of its own contract. In the *Mobile* case, the rate increase filing was accepted by the Commission and allowed to go into effect without suspension under Section 4 of the Natural Gas Act, 15 U. S. C. 717c. In the *Sierra* case, the rate increase was suspended and subjected to a proceeding under Section 205 of the Federal Power Act, which corresponds to Section 4 of the Natural Gas Act. The Commission allowed the increase, finding the rate still below the cost of service. While the Court, in both cases, held that the seller did not have a right to change its contract rate by unilateral action, it stated clearly that these holdings did not impair the regulatory power of the Commission over contract rates. In *Mobile*, it said (350 U. S. at 344):

> Our conclusion that the Natural Gas Act does not empower natural gas companies unilaterally to change their contracts fully promotes the purposes of the Act. By preserving the integrity of contracts, it permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry. * * * On the other hand, denying to natural gas companies the power unilaterally to change their contracts in no way impairs the regulatory powers of the Commission, for the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest.

> The Act thus affords a reasonable accommodation between the conflicting interests of contract stability on the one hand and public regulation on the other.

In *Sierra*, the Court said (350 U. S. at 353):

> * * * The Commission has undoubted power under § 206 (a) to prescribe a change in contract rates whenever it determines such rates to be unlawful. * * *
>
> The condition precedent to the Commission's exercise of its power under § 206 (a) is a finding that the existing rate is "unjust, unreasonable, unduly discriminatory or preferential." * * *

This is precisely what the Commission did here under Section 206 (a) of the Power Act. It reviewed the contract rate filed by petitioner, found it unreasonably high, and prescribed a new rate.

In the *Sierra* case, the Court also found that a contract rate is not invalid solely because it yields less than a fair return on invested capital, for a public utility could agree to such a contract and would not be entitled to be relieved of an improvident bargain except where the rate was so low as to affect the public interest adversely "as where it might impair the financial ability of the public utility to continue its service" (350 U. S. at 355). The Court added that, since the Commission's duty under Section 206 (a) of the Power Act is to protect the public interest, as distinguished from the private interest of the utilities, "it is clear that a contract may not be said to be either 'unjust' or 'unreason-

able' simply because it is unprofitable to the public utility" (350 U. S. at 355). It is evident, as the Commission and the unanimous court below recognized, that this Court was not attempting to prevent regulation of contract rates, as petitioner contends, but was only protecting consumer interests and that the *Sierra* holding can have no application where, as here, the contract rates are found unjust and unreasonable—because excessive—and consequently an unwarranted burden on the ultimate consumer. Having found the contract rate unreasonably high, the Commission was required by statute to fix the just and reasonable rate for the benefit of the ultimate consumer.

2. There is no conflict with the decision in *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U. S. 246, as claimed by petitioner (Pet. 13–15). That case simply reiterated the principle that, when a court passes on rates fixed by a regulatory commission, the rates will not be upset by the court if they come within a "zone of reasonableness." *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 585–586. But there is no basis for petitioner's assertion that the *Montana-Dakota* case requires the Commission (as distinguished from the reviewing court) to exercise a similar latitude in determining whether contract rates are unreasonable. Indeed, it seems clear that the Commission may set aside as unreasonably high any rate which is not the lowest reasonable rate because it produces more than a proper rate of return. Cf. *Federal Power*

Commission v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 586.[2]

Moreover, petitioner makes no criticism of the method used by the Commission in determining the rate of return or any assertion that the 5.55 percent rate of return used by the Commission was unreasonable, but simply complains that the Commission did not compute the rate of return produced by the existing contract rates and then did not find that that rate of return was outside a "zone of reasonableness" which petitioner assumes to exist. In this connection, petitioner notes that it had contended before the Commission that 6 percent was a fair rate of return and that the presiding examiner had supported this position. Petitioner fails, however, to point out that, on the basis of the Commission's findings of the cost of service to Georgia Power Company, the contract rate produces a rate of return of 6½ percent,[3] which

[2] Petitioner's reliance on *Memphis Light, Gas and Water Division, et al.* v. *Federal Power Commission* (C. A. D. C. No. 13666, decided November 21, 1957), pending on writs of certiorari, No. 691, 694, 695, this Term, is also misplaced. The footnote to which petitioner refers (Pet. 15) is not part of the holding of the Court of Appeals, but rather an extra aside of two members of the court, which, as we show in our petition in the *Memphis* case (No. 694, this Term, pp. 25–26), is an incorrect statement of the Commission's practice. It has no application where, as here, the Commission has found that the contract rate is unjust and unreasonable.

[3] The Commission found that the contract rate to Georgia Power Company would produce revenues of $3,247,700, or $252,186 in excess of the cost of service. Included in the cost of service was the return of 5.55 percent or $713,241 (1 R. 116, 118). Thus, if the contract rate were allowed, the return would be the sum of $713,241 return allowed by the Commis-

is in excess of the 6 percent that petitioner claimed to be a reasonable rate of return. Thus, even if petitioner's "zone of reasonableness" argument had any merit in the abstract, which we deny, it could have no application in the circumstances of this case.

3. Contrary to petitioner's bald and unexplained assertion that the record contains no evidence at all to support the three findings of the Commission for which the majority of the court below seeks further explanations on remand, we submit that, as Chief Judge Parker stated in his dissenting opinion, the challenged findings have ample support in the record as it now exists without the need for further explanation or clarification. But even accepting the majority's view that such explanations are appropriate, the issues raised relate to the proper exercise of the Commission's discretion, not to the bare existence of substantial evidence; and, in any event, it seems clear that until the court below has finally disposed of these issues, all of which depend on the peculiar circumstances of this case, review by this Court is unwarranted.

(*a*) Petitioner has objected to the Commission's calculation of income taxes in determining the cost of service because the Commission made allowance only for the taxes payable by petitioner as a separate corporate entity. The Commission computed petitioner's income taxes by deducting the interest paid

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sion and the excess of $252,186, less $131,137 (52%) for federal income tax, or a total of $834,290. This is about 6½ percent on the total rate base of $12,851,181 (1 R. 118).

on its 90 percent debt capitalization, while petitioner would have its income tax allowance computed at the higher figure which would result if its debt ratio were the same as that of the system as a whole. Petitioner's argument has been that its parent, E & G, was forced to issue more common stock to offset the high debt ratio of the subsidiary so that it did not have as large an interest deduction as it otherwise would, and hence paid a higher tax. Thus, petitioner argues that the Commission must compute taxes on a system basis. Petitioner would have the Commission disregard the fact that it was deliberately set up as a separate corporation for the benefit of the parent, that it is operated as a separate entity, and that the service rendered to Georgia Power is not service performed by the system but by petitioner alone. The establishment of petitioner as a separate entity resulted from the parent company's desire to serve the Atomic Energy Commission project. When parent E & G's first offer of a rate to duPont was rejected as too high, it was necessary to develop a financing scheme that would enable the quotation of a lower rate. The 90 per cent debt financing which was adopted was satisfactory for this purpose, but a separate corporation had to be established because of E & G's financial necessities, particularly restrictions in its bond indenture against such high debt financing. To achieve its ends, E & G thus became not the operating company but an investor in petitioner which owns and operates the Urquhart plant. By setting up this separate

corporation, E & G, as the record shows, succeeded in acquiring duPont as a customer, benefiting its territory, and preventing the incursion of public power. In addition, under its contract with Georgia Power, the service rendered by petitioner is only that available from one-half the capacity of the first two units in the Urquhart station, each amounting to 75,000 kw. Unlike petitioner's contract with duPont, the contract with Georgia Power provides for no "back up" of capacity by the E & G system, which means that Georgia Power would be entitled to no power if none were available from the two particular units. While E & G may also have assumed certain burdens because of the utilization of this corporate device, these considerations give support for the Commission decision to determine income taxes on the basis of petitioner's capitalization ratio. Discussing petitioner's contention in this respect, the Commission said (1 R. 109):

> * * * With regard to the income tax allowance, Generating Company uses a hypothetical system capitalization ratio instead of its own actual ratio in order to erase the effect of higher tax costs which E. & G. Co. may incur as a result of the heavy debt financing of Generating Company. This is an attempt to enjoy the benefits of the high-debt financing, i. e., the construction of low cost capacity and the consequent sale to duPont, while making Georgia Power Company and ultimately the consumers in Georgia assume fictitious costs. As such, the allowance proposed by Generating Company is unreasonable.

> We have consistently held that the allowance for taxes should not exceed taxes paid. * * * Accordingly, the income tax allowance in this proceeding should be based upon the actual interest deduction of the Generating Company for that is the basis upon which it will pay its taxes.

Even though the Commission found that the record did not enable it to attribute a precise value to the disadvantages that may have accrued to the parent company as a result of petitioner's high debt financing, these were expressly taken into consideration by the Commission when it permitted the rate of return to be computed on the basis of the capital structure of the E & G system, rather than petitioner's (1 R. 105–106). In addition, as Chief Judge Parker points out, the use of the system capitalization ratio for the purposes of the rate of return, even if it were inconsistent with the use of the company ratio for income tax purposes, could only accrue to the benefit of the petitioner (Pet. App. A 29).

(*b*) As all members of the court below recognized, the modification of the escalation clause in the capacity charge of the contract is a matter for the informed judgment of the Commission. The majority of the court held, however, that the Commission's finding in this respect failed to explain its action. This escalation clause provides for adjusting the capacity charge to reflect changes in working capital, additions to plant, amount of taxes paid, administrative and general expenses, and expenses for operating super-

vision and labor.[4] But these escalation provisions fail to take into account changes in an important element of the capacity cost, namely, the effect of the decline in the rate base due to the increasing reserve for depreciation. The Commission realized that the escalation provisions would clearly tend to favor rate increases rather than decreases, stating (1 R. 137):

> * * * With regard to the escalation clauses affecting the capacity component, it should be noted that the capacity component of the rate to Georgia Power Company is based upon recovery of capacity costs associated with the output of one-half of the total capacity available from two 75,000 kw generators at Plant Urquhart. Confronted with this relatively stable capacity cost situation, the primary problem is not the recovery of unknown and conjectural increases in capacity costs which might occur, but the maintenance of a just and reasonable rate under conditions of a declining rate base. Under these conditions it is probable that the regulatory lag would work more to the seller's benefit than to its detriment.

For this reason, the Commission prescribed a capacity charge which would be fixed except for an adjustment with respect to any increase or decrease in the Federal income tax and required petitioner to eliminate the provisions in the contract which would have the effect of binding the parties to file rate increases without consideration of the declining rate base. It

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[4] Changes in expenses for fuel, maintenance, and related taxes are reflected in the energy charge escalation provisions which the Commission left unchanged.

would appear that the quoted passage shows that, on the record as it now stands, there was no abuse of the Commission's discretion, or, at the least, that a remand is appropriate instead of a reversal. In any event, we do not understand the relation of the substantial evidence rule to this phase of the remand.

(*c*) Petitioner has also urged that the funds invested by E & G in the Urquhart plant during its construction had cost 10 percent so that, during the period of construction, interest on these funds should have been allowed at the rate of 8 percent for the purpose of inclusion in petitioner's rate base rather than the Commission's allowance of 6 percent. In its opinion, the Commission recognized that E & G's investment during construction should be allowed a reasonable rate of interest for the period of construction but added that petitioner should not be permitted to capitalize profits on investment before commercial operation of the plant has begun (1 R. 112). The majority of the court below felt that this did not explain why an element of cost actually experienced should not be included in the rate base, but the majority failed to recognize that the cost of the equity funds was a cost incurred by E & G rather than by petitioner. The basis of the Commission's action is that it is allowing interest on E & G's investment, at a generous rate, but not a return of profits until the plant is in operation. In allowing 6 percent on E & G's equity funds, the Commission was acting in accordance with its Uniform System of Accounts and its past practice which has received judicial ap-

proval. *State Corporation Commission* of *Kansas* v. *Federal Power Commission,* 206 F. 2d 690 (C. A. 8), certiorari denied, 346 U. S. 922. These factors show that there is no basis for petitioner's assertion that the record could not possibly support findings by the Commission on this aspect of the case.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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APPENDIX

The Federal Power Act, 49 Stat. 838, 847, 16 U. S. C. 791a, *et seq.*, provides in pertinent part:

SEC. 205. * * *

(c) Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the

burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending befor it and decide the same as speedily as possible.

SEC. 206. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 762

GEORGIA POWER COMPANY,

Petitioner,

v.

FEDERAL POWER COMMISSION, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Dated January 31, 1958.

TABLE OF CONTENTS

	Page
Opinions Below	2
Jurisdiction	2
Question Presented	2
Statute Involved	3
Statement of the Case	3
The Rate Contract	3-4
The Presiding Examiner's Decision	6-7
Decision of the Commission	7-8
The Opinion of the Court of Appeals	8-9
Georgia's Interest	9-10
Reasons for Granting the Writ	10
Conclusion	16
Appendix—Sections 205 and 206 of the Federal Power Act	17-19

TABLE OF AUTHORITIES

Cases

Page

Federal Power Commission v. *Memphis Light, Gas and Water Division*, No. 694, U. S., October Term, 1957 13

Federal Power Commission v. *Sierra Pacific Power Co.*, 350 U. S. 348 (1956) 3, 7, 8, 10, 11, 14, 15

South Carolina Generating Company v. *Federal Power Commission, et al.*, No. 697, U. S., October Term, 1957 1, 2

Tyler Gas Service Co. v. *Federal Power Commission*, 247 F. 2d 590 (D. C. Cir. 1957), *cert. denied*, 26 U. S. L. Week 3174 (U. S. Dec. 9, 1957) (No. 520) . 14

United Gas Pipe Line Co. v. *Mobile Gas Service Corp.*, 350 U. S. 332 (1956) 2, 7, 8, 10, 14, 15

Statutes

Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C. § 1254(1) 2

Federal Power Act, Title II, 49 Stat. 847 (1935), 16 U. S. C. § 824 *et seq.* 3

Natural Gas Act, 52 Stat. 821 (1938), 15 U. S. C. § 717 *et seq.* 8

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Georgia Power Company (Georgia) prays that a writ of certiorari issue to the United States Court of Appeals for the Fourth Circuit to review a judgment of that court remanding the cases before it to the Federal Power Commission (the Commission) for further proceedings as indicated in the court's opinion. Georgia contends that the Commission's order should have been wholly and finally set aside for reasons definitively rejected by the court in its opinion.

A petition for a writ of certiorari has already been filed by South Carolina Generating Company (Generating Company) and assigned No. 697 on this Court's appellate docket.

Opinions Below

The opinion of the Court of Appeals has not been reported but is set forth at Appendix A to Generating Company's petition in No. 697. The opinion and order of the Commission appear at 16 F.P.C. 52 and 15 P.U.R. 3d 289 and are set forth at pages 93 through 120 of Volume I of the transcript of the record as certified by the clerk of the court below.[1]

Jurisdiction

The judgment of the Court of Appeals is dated and was entered October 23, 1957. By order dated November 23, 1957, the Court of Appeals denied a petition for rehearing filed by Generating Company.

The jurisdiction of this Court is invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U.S.C. § 1245(1) and Section 313(b) of the Federal Power Act, 16 U.S.C. § 8251(6).

Question Presented

Under the decisions of this Court in *Mobile*[2] and *Sierra*,[3] may the Commission set aside rates fixed by a contract between two utilities which are under no obligation to serve each other, upon the sole ground that the rates do not conform with the Commission's determination of "reasonable rates" under the "cost-of-service formula" and

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1. The transcript of record as certified consists of six volumes. Record references herein are to the respective volumes by Roman numeral, followed by Arabic numbers designating pages of the volume referred to as originally paginated. Nine copies of the volumes referred to herein (I, II and V) were filed with the Clerk of this Court by Generating Company in No. 697. Volume I is the same as Part I of petitioners' appendix in the court below, Volume II is the same as Part II of such appendix and Volume V is the same as the Commission's appendix in the court below.

2. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U. S. 332.

3. *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U. S. 348.

where it affirmatively appears that the contract benefits the consumers of both parties?

Statute Involved

The statutes involved are §§ 205 and 206 (16 U.S.C. §§ 824d and 824e; Appendix *infra*) of the Federal Power Act, Title II, 49 Stat. 847 (1935), 16 U.S.C. § 824 *et seq.*

STATEMENT OF THE CASE

The Rate Contract

Georgia is a public utility engaged in the business of generating and distributing electric energy in all but five of the State's 159 counties. In 1951, it became necessary for Georgia to increase its capacity or find a new source of power in its Augusta area in order to meet the expanding service requirements of that part of the State. Accordingly, it made plans for the construction of a new steam generating plant, acquired land, and ordered a generator for that purpose in the neighborhood of Augusta (R. II, 143).

South Carolina Electric & Gas Company (E & G) is a public utility carrying on an electric generating and distributing business in a wide area of South Carolina. Its service area borders in part on Georgia's. Before Georgia had started constructing the proposed Augusta plant, its management learned of E & G's plans to build a substantial new generating plant within two miles of the site acquired by Georgia, for the purpose of obtaining new capacity for E & G's own distribution needs and also serving a new plant being constructed by the Atomic Energy Commission. Fully conscious of its obligation to serve its customers at the lowest possible cost, Georgia's management entered into negotiations with officials representing E & G and its newly formed subsidiary, Generating Company, which was organ-

ized by E & G for the purpose of constructing the proposed plant (R. II, 160-163).

During the course of the negotiations, it was determined that Generating Company could produce the power needed by Georgia at an average of $11.30 per kw a year less than the same power would have cost if produced by Georgia itself in its proposed new plant (R.I., 146). This saving in costs resulted primarily from the circumstance that Generating Company was so organized as to enable it to obtain its financing on a 90% debt to equity ratio. However, neither E & G nor Generating Company was under any legal obligation to furnish power to Georgia, neither was affiliated with Georgia in any way, and the proposed plant's capacity as then projected by Generating Company could have been used entirely in the E & G system (R.V., 49) or cut back before actual construction (R.V., 54). Accordingly, after extended bargaining, and in order to induce Generating Company to supply its needs, Georgia agreed to a charge per kw designed to fall about equally between the estimated cost to Georgia of producing energy at its proposed plant and the estimated cost at the proposed Generating Company plant (R. II, 164). A rate contract embodying this capacity charge and covering 75,000 kw (*i.e.*, one-half of the capacity of the proposed plant), was then worked out and signed on November 9, 1951. Georgia cancelled its proposed Augusta plant, while Generating Company proceeded with its proposed plant, which began operation in 1954. As signed, the contract contained a recapture or cancellation clause which is customary in arrangements of this kind (R. II, 145).

As the Court of Appeals recognized in its opinion, the net result of the contract to Georgia was to effect a saving in power cost to Georgia in the sum of about $600,000 per year (R. I, 88; II, 165), "so that its retail consumers in Georgia were also benefited" (Gen. Co.'s pet. for cert.,

p. App. 7). As testified by Georgia's President at the hearing before the Commission (R. II, 147):

> "• • • I think the contract was good at the time it was made and I think it is still a good contract."

As the Court of Appeals also recognized in its opinion, the net result of the contract to Generating Company and its parent E & G was to assist in the financing of Generating Company's new plant as a two-unit, 150,000 kw facility rather than a one-unit, 75,000 kw facility (R. II, 147-148). The use of two units rather than one, in addition to serving E & G's corporate policy of building capacity as warranted by demands, also resulted in lower unit costs which were considered in setting the contract rate to Georgia (R. II, 148). However, as shown at pages 4 and 5 of Generating Company's petition for certiorari, the construction of the new plant by Generating Company, and its unusual financial structure, placed a considerable financial burden on E & G because of the unitary economic nature of the E & G-Generating Company system. One of the purposes of the allocation of the savings resulting from the plan envisioned by the contract was to help defray these added costs which otherwise would have had to be borne by E & G's consumers.

Despite the advantages to Georgia and its retail consumers resulting from this contract, the Public Service Commission of the State of Georgia complained to the Federal Power Commission of discrimination arising from the fact that the rate charged Georgia was substantially higher than the rate charged by Generating Company to its parent, E & G—a fact which was, of course, inherent in the plan, as was well known to all parties at the time the contract was entered into. The Commission thereupon entered into formal hearings, at which all of the above facts were concededly established, and its Presiding Examiner thereafter issued an order approving the rate and terminating the Commission's investigation.

The Presiding Examiner's Decision

In his order the Presiding Examiner found that certain facts, which we think are controlling, had been established by uncontroverted evidence, and, although the Commission subsequently reversed his decision, it did not in its order disagree that said facts had been established by uncontradicted evidence. The Presiding Examiner found that:

> "* * * The Georgia Power Company contract is mutually advantageous to the Georgia Company and its rate payers and to the S. C. Company and its rate payers. There is no evidence in this record that any one or more of the modifications of the Georgia Power contract suggested or recommended on this record would be advantageous to the Georgia Company or its rate payers. The logic of the facts of record is that a reduction of the charges by Generating Company to Georgia Company might with more likelihood bring about a recapture of the 75,000 kw capacity (with this Commission's approval) to the detriment of Georgia Company and its rate payers than likely to bring any benefit to the Georgia Company and its rate payers. The preponderance of the evidence of record is to the foregoing effect. The evidence is *uncontroverted* that Georgia Company has obtained and enjoys today for the benefit of its rate payers the *cheapest* source of 75,000 kw of electric energy available to it, and that it could not in the past, nor can it now, produce the energy at such low cost to it. The evidence is *uncontroverted* that Georgia Company saves about $600,000 a year by reason of the contract for the 75,000 kw." (Italics supplied) (R.I., 87-88)

The Presiding Examiner also found that:

> "* * * There is no evidence that any Georgia rate payer is required to pay a single cent more by reason of the low charges to the United States Government agency, AEC. If any rate payers are affected adversely, it would be the South Carolina customers of S. C. Company, not the customers of Georgia Company. But were the recommendations accepted to reduce the

charges to Georgia Company because of the lower contract charges to AEC, the South Carolina customers would be required to make up the loss to the S. C. Company system of revenues below its cost to serve, including a reasonable return. Upon this record that would constitute a subsidy to the customers of the Georgia Company at the expense of the customers of South Carolina Electric & Gas Company." (R.I., 92.)

Decision of the Commission

As above pointed out, the Commission reversed the Presiding Examiner's order dismissing the proceedings and issued its opinion and order setting the contract aside.

The Commission approached the problem exactly as it had that presented to it in *Sierra* and *Mobile*:

"• • • The first issue is whether the rate to Georgia Power Company should be based upon cost of service on a net investment rate base or whether the rate should take into account the value of service to Georgia Power Company." (R.I., 98.)

Asserting that "it is clear that we are required to *fix* a rate in the public interest" (emphasis supplied), the Commission concluded "that the cost-of-service formula is the one best adapted in determining just and reasonable rates in this industry where all costs are known or clearly determinable" (R. I, 100). The Commission expressly rejected what it described as the "value-of-service formula" advocated by the Generating Company, on the ground that "approval of a rate based upon recognition of these elements foreign to any cost formula would be a radical departure from established rate making principles utilized by this Commission" (R. I, 99). Accordingly, as the contract rate produced a higher return than would be allowable under a rate fixed on the basis of the cost-of-service formula, the Commission set it aside. The Commission's only attempt to distinguish *Mobile* and *Sierra* was that,

"Our investigation and findings herein are precisely the type of regulation which those cases sanction." We assume the Commission was referring to the fact that this was a proceeding under § 206(a) of the Federal Power Act whereas in *Mobile* and *Sierra* the proceedings were initiated under § 205(d) and (e) (or the comparable provisions of the Natural Gas Act, 52 Stat. 821 (1938), 15 U.S.C. § 717 *et seq.*).

Generating Company, as well as the South Carolina Public Service Commission, filed petitions for review (under § 313(b) of the Federal Power Act) in the Court of Appeals for the Fourth Circuit, asserting, among other things, that the Commission's order was in direct conflict with the express holding of this Court in *Sierra* that the cost-of-service formula was an "erroneous standard" to be applied in setting aside a contract rate. Georgia moved in that court to intervene in support of the petitioners on the grounds hereinafter stated, and such motion was granted by the Court of Appeals in its judgment of October 23, 1957.

The Opinion of the Court of Appeals

The court below, although recognizing that the petitioners' argument based upon this Court's decisions in *Mobile* and *Sierra* "seems to have great logical force," sought to distinguish those cases on the ground that there this "Court was dealing with rates, too low to permit an adequate return according to accepted standards," whereas, "In the pending case, to the contrary, we are dealing with a rate that was too high according to accepted standards of rate regulations." The Court continued:

> "• • • The case before us comes down to the inquiry whether the utilities *were justified in retaining for themselves the savings* inherent in a situation which developed in 1950 and led to the organization of the Generating Company. At that time the pressing need for more power, felt by E & G, the Georgia Power

Company, and the Atomic Energy Commission, culminated in an arrangement *which was beneficial to all concerned.* Undoubtedly the successful solution was due in large measure to the experience and enterprise of the interested parties, *but it does not follow that they were entitled to all of the savings* which actually flowed from the natural growth and economic development of the area. The problem presented to the Commission was not substantially different from that which usually arises when a public utility, *by the force of circumstances a natural monopoly, seeks to furnish a commodity to the general public;* the reasonableness of its proposed rate must be considered, and the answer is found by allowing a reasonable return upon the investment." (Italics supplied) (Gen. Co.'s pet. for cert., pp. App. 11-12.)

Georgia's Interest

It is, of course, to Georgia's interest, as well as its duty as a public utility, to obtain the cheapest available power for the benefit of its customers. Accordingly (disregarding for the moment Georgia's natural desire to live up to its contract), if there were no doubt but that the Generating Company could be compelled to sell power to Georgia for the duration of the contract at the rates now fixed by the Commission, it might well be to Georgia's interest to accept the Commission's order. However, the contract here in issue expressly provides that Generating Company may reduce the amount of power which it is required to furnish Georgia in a very substantial amount on twelve months' notice, and may terminate the contract entirely on thirty months' notice. While the Commission stated in its decision that it might attempt to prevent Generating Company from exercising the cancellation provision, it is by no means clear that the Commission has the legal power to do so. Nor is it clear that, even assuming the Commission to have such power, the facts would be such as to compel or justify its exercise. Because the contract rate is substantially lower than would be the cost to Georgia of

providing the contract power itself from a like-size plant in the same area if the contract were terminated, Georgia believes it is to its interest to uphold the contract.

Moreover, Georgia believes that it is to its long-run interest, as well as in the public interest, that a contract of this nature be held valid and binding in accordance with its terms. Otherwise, it will be difficult, if not impossible, for Georgia—or any other utility similarly situated—to enter into economically desirable arrangements with neighboring generating companies which are not obligated to serve it, even though such companies would otherwise be able and willing to serve Georgia at costs lower than those at which Georgia could produce its own power. Thus, the effect of the judgment below may well be to interfere with Georgia's ability to obtain power to meet its future needs on economically desirable terms otherwise available.

For these reasons, Georgia believes it is to its interest to oppose the Commission's order and the decision below. It does so on the ground that both the Commission and the court below have wholly misconceived the Commission's power and functions under the Federal Power Act as analyzed by this Court in *Sierra* and *Mobile*.

Reasons for Granting the Writ

The effect of the decision below is to sustain the Commission's attempt to reestablish the very theories of rate regulation which were expressly rejected by this Court in *Mobile* and *Sierra*: That it is the Commission's function to "fix" all rates at a level where they will produce a "fair return" to the seller when measured by the "cost of service formula." Indeed, in this respect the Commission's opinion and order is couched in almost the identical language used in its briefs in support of the orders which were reversed in those cases.

The Commission's apparent attempt to distinguish those cases on the procedural ground that it is now proceeding under § 206(a) instead of § 205(d) and (e) is no distinction at all. This Court expressly rejected the Commission's contention in *Sierra* that if necessary it would set aside the contract there in issue under § 206(a) "solely because it yields less than a fair return on the net invested capital," holding that that contention "appears on its face to be based on an erroneous standard" (350 U.S. at 354-355). The issue here is not whether the Commission adopted the right procedure, but whether it applied the right standard.

So also, the attempt of the court below to distinguish *Sierra* and *Mobile* on the ground that there the court was dealing with a low rate whereas here the court was dealing with a high rate when measured on the basis of the cost of service formula, is a distinction without a difference.

In *Sierra*, speaking of the low rate there in issue, this Court said:

> "* * * while it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain. Cf. *Arkansas Natural Gas Co. v. Railroad Comm'n*, 261 U.S. 379. In such circumstances the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." (350 U.S. at 355.)

That that reasoning is equally applicable to the case at bar where the buying utility has agreed to pay a rate which

would produce *more* than "a fair return" is readily apparent. To paraphrase Sierra:

> "* * * while it may be that the Commission may not normally *impose* upon a [buying] public utility a rate which would produce [more] than a fair return [and that the seller cannot normally charge such a rate], it does not follow that the [buying] utility may not itself agree by contract to a rate affording [more] than a fair return * * * In such circumstances the sole concern of the Commission would seem to be whether the rate is so [high] as to adversely affect the public interest—as where it might impair the financial ability of the [buying] utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory."

We submit that a contract such as that here in issue, which concededly saves the buying utility $600,000 a year, clearly does not violate any such standards, and cannot be "adverse to the public interest" on any theory.

We would point out also that the court below was clearly in error in assuming that in the case at bar the buying and selling utilities were "retaining for themselves the savings inherent in [the] situation." It is plain on its face that the savings in cost of power to Georgia will be passed on to Georgia's consumers in the normal course of the performance of the Georgia Commission's regulatory functions. Similarly, as the South Carolina Commission has expressly pointed out, because E & G and South Carolina are an economic unit, it follows that if Generating Company is deprived of its profit under this contract, the resulting amount would have to be made up by increasing the rates payable by E & G's customers (R. I, 11; II, 201; petition by So. Car. P.S.C. for rehearing below, p. 3). Thus there is no basis whatever for the assertion of the Court of Appeals that the two companies were "retaining for themselves the savings inherent in" this situation. On the con-

trary, the purpose and effect of the contract is to divide those savings between the *consumers* of both Generating Company's parent and Georgia.

We suggest that the error of the court below flows from its failure to appreciate the difference between the duties and powers of the Commission in regulating wholesale sales and those of a state commission regulating retail sales to the ultimate consumers. In the latter situation, as the court below correctly observed, the seller, "by the force of circumstances a natural monopoly, seeks to furnish a commodity to the general public; the reasonableness of its proposed rate must be considered, and the answer is found by allowing a reasonable return upon the investment" or other proper rate base. In such circumstances, there is no reason for special rate contracts: no purchaser would willingly agree to pay more, and no seller to accept less, than an amount sufficient to allow a reasonable return on a proper rate base, for that is what each is entitled to demand as a matter of law.

A somewhat similar situation may also arise where a natural gas pipe line company, having built a line into a given territory, is generally in the position of a "natural monopoly." Where no special circumstances require a special rate, such as in *Mobile*, it is customary for such companies to enter into "service agreements" for the sale of the commodity at whatever rate may be lawfully on file from time to time under the supervision of the appropriate regulatory authority. See, for example, the record in *Federal Power Commission* v. *Memphis Light, Gas and Water Division*, No. 694, U.S., October Term, 1957, in which petitions for certiorari are now pending before this Court.

But that is not this case. Insofar as Generating Company's relations with Georgia are concerned, no element of "monopoly" was involved at all. It was not seeking to

furnish power to Georgia. Indeed, it was under no obligation to sell to Georgia, and Georgia was under no constraint to buy from it except on terms beneficial to Georgia. The question was simply whether it was more economical and beneficial to both companies and the consumers of each for the companies to enter into this contract, or for Georgia to produce its own power.

It must be obvious that where a utility is *not* "by the force of circumstances a natural monopoly" many situations will arise where without a binding contract for a special rate, there will be no sale. For example without special rates Sierra and Tyler[4] would have purchased from other potential suppliers, and the Ideal Cement Company involved in *Mobile* would have moved its plant elsewhere. So here but for the special rate embodied in this contract Georgia would presumably have had to produce its own power. We submit that the essence of this Court's decisions in *Mobile* and *Sierra* is precisely that, because economic conditions often make individualized arrangements necessary and beneficial in the wholesale field, Congress intended that companies should be as free to enter into them under the Federal Power and Natural Gas Acts as they would be if no acts existed. The only effect of the Acts in such situations is to require notice, and empower the Commission to set such contracts aside if the public interest so requires—and that means something more than a mere determination that the rate is either higher or lower than the rate the Commission would impose.

Not only is there no showing in the present case that the public interest requires the present contract to be set aside, but on the contrary it is plain on the conceded facts that

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4 The purchaser in *Tyler Gas Service Co. v. Federal Power Commission*, 247 F. 2d 760 (D. C. Cir. 1957), *cert. denied*, 26 U. S. L. Week 3174 (U. S. Dec. 9, 1957) No. 520.

it is beneficial to the public interest: It results in lower rates to the consumers of both buyer and seller than would have been possible if there had been no contract.

To be sure, the decision below seeks to preserve the resulting savings by allocating them exclusively to the consumers of the buyer. But such allocation is not only in direct violation of the contractual arrangement between the parties, it also is made without any properly based finding that the agreed upon allocation is not in the public interest. Moreover, as indicated above, if the decision below is allowed to stand, it would undoubtedly accelerate the exercise by the seller of its recapture powers, to the great detriment of Georgia. Further, it would probably make it impossible for any utility to enter into such an arrangement in the future however advantageous to the ultimate consumers it might be. Certainly in the present instance it seems clear from the fact that the contract was only entered into after extensive arm's length bargaining, that except for the advantageous rate, Generating Company would not have agreed to sell power to Georgia at all—thus increasing the cost of power to Georgia's consumers by $600,000 per year.

We submit that the decision below directly contravenes the construction of the Natural Gas and Federal Power Acts set forth in this Court' opinions in *Mobile* and *Sierra*, and reintroduces into their administration the very confusion and uncertainty which existed before those cases were decided. As the Acts vitally affect two of the largest industries in the country, it is respectfully submitted that the Court grant the writ applied for.

Conclusion

The petition for certiorari should be granted.

Respectfully submitted,

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Of Counsel.

January 31, 1958.

APPENDIX

Sections 205 and 206 of Federal Power Act.

Sec. 205. (a) All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take

effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [49 Stat. 851; 16 U.S.C. 824d.]

Sec. 206. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that

any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

(b) The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy. [49 Stat. 852; 16 U.S.C. 824e.]

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IN THE

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OCTOBER TERM, 1957

No. 762

GEORGIA POWER COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION, *et al.*,
Respondents.

REPLY BRIEF OF GEORGIA POWER COMPANY ON PETITION FOR CERTIORARI

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Dated March 11, 1958.

IN THE

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Respondents.

REPLY BRIEF OF GEORGIA POWER COMPANY ON PETITION FOR CERTIORARI

The briefs filed by the Federal Power Commission in opposition to the petition for a writ of certiorari herein, as well as in Nos. 782 and 697, indicate the most cogent reason why the writs should be granted. For it is clear from those briefs that the Commission wholly misconceives the basis of this Court's decision in *Sierra* that a rate fixed by contract can be set aside by the Commission only if it adversely affects the public interest: Despite this Court's decision that the rate involved in *Sierra* could not be set aside solely because the Commission deemed it "unreasonable" when measured by "the cost of service formula", the Commission insists upon applying that erroneous standard to the rate here in issue.

We submit that the Commission has overlooked the true basis of this Court's decision in *Sierra*: that in setting aside a rate fixed by contract the Commission is exercising the paramount power of the Government to set contracts aside, and that that power can be exercised only when the public interest so requires. If a contract providing for a special rate is "unreasonable" merely because the rate produces a return different from that which the Commission would approve by applying the "cost of service formula," there could be no such contracts.

Respectfully submitted,

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Counsel for Petitioner.

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Dated March 11, 1958.

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BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion and orders of the Federal Power Commission (1 R. 93-120, 135-139)[1] are reported at 16 F.P.C. 52 and 1365. The opinions of the United States Court of Appeals for the Fourth Circuit are reported at 249 F.2d 755 and are set forth in Appendix A to the petition in No. 697, this Term.

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[1] The record here is the same as that filed in No. 697, this Term. The record consists of six volumes. Thus, 1 R. —— refers to the first volume.

JURISDICTION

The judgment of the Court of Appeals was entered on October 23, 1957. A petition for rehearing, timely filed, was denied on November 23, 1957. The petition for a writ of certiorari was filed on February 3, 1958. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Federal Power Commission, acting pursuant to Section 206(a) of the Federal Power Act, may reduce a contract rate when it finds that the rate is unjust and unreasonable on the basis of cost of service.

STATUTES INVOLVED

The pertinent provisions of the Federal Power Act are set forth at pages 17-19 of the petition.

STATEMENT

Petitioner, Georgia Power Company, intervened below in the review proceedings which challenged an order of the Federal Power Commission reducing the rates on a wholesale purchase of electric energy established in a contract between the South Carolina Generating Company, as seller, and the Georgia Power Company, as purchaser. The petition seeks review of that portion of the decision of the Court of Appeals which affirms the Commission's holding that the reasonableness of the contract rate should be determined by cost of service, not by the value of the service to the purchaser. The pertinent facts are set forth in

the Federal Power Commission's brief in opposition to the petition filed by the selling utility in *South Carolina Generating Company* v. *Federal Power Commission, et al.*, No. 697, this Term, to which we respectfully refer the Court.

ARGUMENT

This petition involves substantially the same issue as the first question in the petition filed in *South Carolina Generating Company* v. *Federal Power Commission, et al., supra*, pages 8-13. For the reasons stated at pages 7-10 of our brief in opposition to that petition, it is respectfully submitted that this petition should likewise be denied.

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FEBRUARY, 1958

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SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
PETITIONER,

versus

FEDERAL POWER COMMISSION AND GEORGIA PUBLIC SERVICE COMMISSION, RESPONDENTS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

T. C. CALLISON,
Attorney General for South Carolina,

IRVINE F. BELSER,
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Counsel for Petitioner.

INDEX

	PAGE
Citation to Opinions Below	1
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement	2
The Georgia Power Contract	4
Proceedings Before the Federal Power Commission	5
The Court of Appeals	5
Reasons for Granting the Writ	6

CITATIONS

	Page
F. P. C. v. Sierra, 350 U. S. 348, 355	5, 6, 7, 8
F. P. C. v. S. C. Generating Co., 249 F. (2d) 755	1
United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U. S. 332 (1956)	7

Supreme Court of the United States

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No. .....

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
PETITIONER,

versus

FEDERAL POWER COMMISSION AND GEORGIA PUBLIC SERVICE COMMISSION, RESPONDENTS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Petitioner prays that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, entered in the above-entitled case on October 23, 1957.

CITATION TO OPINIONS BELOW

The Opinion and Order of the Federal Power Commission, issued October 2, 1956, is reported at 16 F. P. C. 52. The opinion of the Court of Appeals for the Fourth Circuit of October 23, 1957, is reported in 249 F. (2d) 755

and is printed as an Appendix to the Petition in No. 697.[1] The Order of the Court of Appeals denying petitions for rehearing was entered on November 30, 1957.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on October 23, 1957. Rehearing was denied on November 23, 1957. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTION PRESENTED

Where two unaffiliated electric utilities, after arms' length bargaining, enter into a mutually advantageous 25 year contract for the purchase and sale of 75,000 KW, under which the buying utility obtains electrical energy at a cost of approximately $600,000.00 per year less than it could obtain the energy from other sources, and where the regulating agency in the state where the seller operates has approved the financing of the generating plant and the contract in issue, may the Federal Power Commission set aside the contract solely because its rates, reviewed in the light of the Commission's cost to serve formula, yield to the seller more than a fair return on its net investments?

STATUTE INVOLVED

The Statutes involved are Sections 205 and 206 of the Federal Power Act (16 U. S. C. A. 824(d), 824(e).

STATEMENT

In planning its program for additional generating facilities to meet increasing post war demands, the South

[1] A Petition for Certiorari to review the same judgment of the Court of Appeals for the Fourth Circuit has been filed by the South Carolina Generating Company in the United States Supreme Court (No. 697). References herein are to the Record and Appendix filed with that Petition.

Carolina Electric and Gas Company (Electric and Gas) [2] was confronted in 1950 with the necessity of providing electrical energy for the Atomic Energy Commission's H-Bomb site being constructed for it by du Pont in that portion of South Carolina served by Electric and Gas.

In negotiating terms it soon became apparent that du Pont would not accept rates based on conventional financing (not over 60% debt) of a new generating plant. Since the indenture provisions of bonds then outstanding did not permit Electric and Gas to finance with a debt ratio in excess of 65%, Electric and Gas decided to organize a wholly owned subsidiary, South Carolina Generating Company, to finance, build, and operate the new facility to be located in South Carolina on the Savannah River near Augusta. At a later date this became known as the Urquhart Station.

Since Electric and Gas operated only in South Carolina, this Petitioner was charged with the regulatory supervision of this utility, including the utility's financing. (§ 24-1 *et seq.* South Carolina Code of 1952.) Therefore Electric and Gas brought to the South Carolina Public Service Commission for approval a proposal authorizing it to carry out the said plans, and specifically authorizing it (1) to have the Generating Company build the Urquhart Station with two 75,000 KW steam generating units; (2) to sell to du Pont for the use of A. E. C. 30,000 KW of the output; (3) to finance this construction by the sale of bonds for 75 per cent. of the cost, notes for 15 per cent. of the cost, and common stock to the parent for 10 per cent. of the cost; and (4) to sell to Georgia Power Company 75,000 KW over a twenty-five-year period under the terms and conditions in the contract in issue here.

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[2] The South Carolina Electric and Gas Company serves the eastern and southern parts of South Carolina with electrical energy.

After fully considering all facets of these proposals, the South Carolina Commission approved the plan. (II 202-208.) Generating Company was organized, the Urquhart plant was built, financing was accomplished, and the contracts with du Pont and Georgia Power were duly executed and delivered, all in accordance with the orders of the South Carolina Public Service Commission.

THE GEORGIA POWER CONTRACT

The Georgia Power Company operates only in the State of Georgia. Like Electric and Gas, it has generating, transmission and distribution facilities. It is more than twice as large as Electric and Gas. There is no corporate or financial connection between the two.

In 1950, when Electric and Gas began planning its Urquhart plant to serve du Pont and its other customers, Georgia Power was in need of additional generation in the Augusta, Georgia, area to serve its increasing demands. Learning of Electric and Gas' plans to serve du Pont, it approached Electric and Gas to obtain a part of this energy. All of the negotiations between Georgia Power and Electric and Gas were at arms' length. Each party had the benefit of competent advice. The rate finally reached was in two parts. The energy component based on the cost of fuel and other operating costs are not at issue here.

In reaching an agreement on the capacity component, the parties made a comparison between the cost of generating 75,000 KW at Urquhart and the cost to Georgia Power of obtaining the same capacity from a plant built by it or from any other source. It was found that under the contract rate the Georgia Power Company would obtain this capacity for $600,000.00 less than it could from any other source. The cost of generating at Urquhart was substantially less primarily because of its high debt financing of 90%. Equity

money is much more expensive to an electrical utility than is debt money. In this case the F. P. C. puts the cost of equity at 10.50%, debt at 3.46% (I, 108). In addition to this difference in money cost, interest on debt, in calculating net operating income for a utility, comes ahead of Federal income taxes; so that the Generating Company could properly sell power to the Georgia Power Company for less than the said Company itself could produce such power.

PROCEEDINGS BEFORE THE FEDERAL POWER COMMISSION

The Federal Power Commission, after various conferences, initiated an investigation of the contract rate in October, 1954. A hearing resulted, and on March 1, 1956, the Examiner issued his report upholding the contract rate and dismissing the proceeding. The Commission, disregarding *in toto* the findings and the tentative opinion of its examiner, ordered the rate to the Georgia Power Company reduced by $252,186.00 annually (I, 116). Added to the admitted annual savings of $600,000.00, the effect of this order is to give Georgia Power Company, and therefore to its customers, the use of 75,000 KW at $852,000.00 below what said Company could obtain this power elsewhere.

THE COURT OF APPEALS

The Court of Appeals refused to apply the doctrine of *Federal Power Commission v. Sierra*, 350 U. S. 348, holding that this decision applied only when the rates of the selling utility were **too low**, not when **too high**. However, a majority of the Court was dissatisfied with the Commission's treatment of Federal income taxes and other items and remanded the case for a better explanation of the Commission's actions in these particulars.

REASONS FOR GRANTING THE WRIT

The regulation of the electric service of the Electric and Gas Company is primarily the responsibility of the South Carolina Public Service Commission. The Georgia Power contract at issue here is the only part of the business of Electric and Gas which is subject to Federal Power Commission review.

When Electric and Gas presented to the S. C. Commission its request for the approval of the creation of this subsidiary, with its high debt financing, that Commission withheld its approval of the plan until a contract was submitted showing an equitable plan for sharing the savings to be effected by the high debt financing. App. II, pp. 199-201; see also pp. 164-165.)

This contract between Georgia Power and South Carolina Generating Company was approved by the S. C. Commission because it was mutually beneficial (I, 87), and was an arms' length bargain. Without this approval by the South Carolina Commission, this arrangement could not have been made. Because of this mutual benefit, the South Carolina Commission takes the position that it is consistent with the public interest for Georgia consumers to receive $600,000.00 of annual benefits. Now the Federal Power Commission orders an additional $250,000.00 of benefits each year to the Georgia consumers. Since an electrical utility has no revenue other than its customers and since Electric and Gas operates only in South Carolina, it is obvious that, in order to give the Generating Company and Electric and Gas a fair return upon its investment, this $250,000.00 rate reduction to Georgia customers will come from South Carolina customers of Electric and Gas.

In the *Sierra case* this Court held that where two utilities, bargaining at arms' length, negotiate a long term wholesale contract, the rates and charges therein could not

be increased by the Federal Power Commission merely because the contract yielded **less** than a fair return on its net investment. Said the Court, in giving its reasons for its decision:

> "In such circumstances the **sole** concern of the Commission would seem to be whether the rate is so low as **to adversely** affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." 350 U. S. 355.

The Fourth Circuit refused to follow the reasoning of this case because it thought *Sierra* had no applicability to a situation where the rates yielded to the selling utility **more** than a fair return on its net investment. (App. 11.)

We submit that such a limitation on Sierra is not justified. The responsibility of the Federal Power Commission under Sections 205 and 206 is to review rates which are unreasonably high or unreasonably low. The statute makes no distinction.

The Federal Power Commission has no power to fix rates. (*United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U. S. 332 (1956).) Under the *Sierra case*, that Commission's power to modify rates agreed upon between two utilities as a result of arms' length bargaining is limited to cases where the rates so agreed upon are such as to adversely affect the public interest by impairing the ability of the utility to continue its service or to cast upon other consumers an excessive burden. In the case at bar both Georgia Power and South Carolina Electric and Gas are engaged in generation, transmission and distribution of energy. Any contract between the two whereby one sells and one buys primarily affects, in reality, only consumers. That is so because all electrical utilities of this type necessarily obtain all their revenues from consumers. Therefore,

the review powers of F. P. C. are for the protection of the customers of the seller as well as the customers of the buyer.

When the Federal Power Commission saw from the undisputed testimony (II, 165; I, 89) that the consumers of Georgia Power were receiving an annual benefit from the contract of $600,000.00, its review function was at an end. *Federal Power Commission v. Sierra, supra.* All other regulation was for the State Commission.

It is submitted that the necessary and useful power of the Federal Power Commission to modify in the public interest contracts between public utilities operating in different states is, in justice, in reason, and by authority, limited to cases where it can be shown that such contracts, especially where negotiated between utilities at arms' length, impair the ability of the utilities to serve the public. Hence, the Order of the Federal Power Commission in the case at bar should be reversed.

Respectfully submitted,

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Attorney General for South Carolina,

IRVINE F. BELSER,
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Counsel for Petitioner.

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[1] The record here is the same as that filed in No. 697, this Term. The record consists of six volumes. Thus, 1 R. —— refers to the first volume.

JURISDICTION

The judgment of the Court of Appeals was entered on October 23, 1957. A petition for rehearing, timely filed, was denied on November 23, 1957. The petition for a writ of certiorari was filed on February 11, 1958. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Federal Power Commission, acting pursuant to Section 206(a) of the Federal Power Act, may reduce a contract rate when it finds that the rate is unjust and unreasonable on the basis of cost of service.

STATUTES INVOLVED

The pertinent provisions of the Federal Power Act are set forth at pages 19-21 of the appendix to our brief in opposition in No. 697, this Term.

STATEMENT

Petitioner, South Carolina Public Service Commission, was one of the petitioners below in the review proceedings which challenged an order of the Federal Power Commission reducing the rates on a wholesale purchase of electric energy established in a contract between the South Carolina Generating Company, as seller, and the Georgia Power Company, as purchaser. The petition seeks review of that portion of the decision of the Court of Appeals which affirms the Federal Power Commission's holding that the reasonableness of the contract rate should be determined by

cost of service, not by the value of the service to the purchaser. The pertinent facts are set forth in the Federal Power Commission's brief in opposition to the petition filed by the selling utility in *South Carolina Generating Company* v. *Federal Power Commission, et al.*, No. 697, this Term, to which we respectfully refer the Court.

ARGUMENT

This petition involves substantially the same issue as the first question in the petition filed in *South Carolina Generating Company* v. *Federal Power Commission, et al., supra*, pages 8-13. For the reasons stated at pages 7-10 of our brief in opposition to that petition, it is respectfully submitted that this petition should likewise be denied.

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